KPMG

LONG ISLAND POWER AUTHORITY

(A Component Unit of The State of New York)

Basic Financial Statements

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)

LONG ISLAND POWER AUTHORITY
(A Component Unit of The State of New York)

Basic Financial Statements

Table of Contents

KPMG LLP
Suite 200
1305 Walt Whitman Road
Melville, NY 11747-4302

Independent Auditors' Report

The Board of Trustees
Long Island Power Authority:

We have audited the balance sheets, statements of revenues, expenses, and changes in net assets, and statements of cash flows of the Long Island Power Authority (Authority), a component unit of the State of New York, as of and for the years then ended December 31, 2007 and 2006, which collectively comprise the Authority's basic financial statements. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 17, 2008 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope and of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 3 through 13 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 17, 2008

Overview of the Financial Statements

This report consists of three parts: management's discussion and analysis, the basic financial statements, and the notes to the financial statements.

The financial statements provide summary information about the Authority's overall financial condition. The notes provide explanation and more details about the contents of the financial statements.

The Authority is considered a special-purpose government entity engaged in business-type activities and follows financial reporting for enterprise funds. The Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). In accordance with GASB standards, the Authority has elected to comply with all authoritative pronouncements applicable to nongovernmental entities (i.e. pronouncements of the Financial Accounting Standards Board) that do not conflict with GASB pronouncements.

The following is a summary of the Authority's financial information for 2007, 2006, and 2005 (thousands of dollars):

Balance Sheet Summary

		December 31		
		2007	**2006**	**2005**
Assets:				
Current assets:				
Cash, cash equivalents and investments	$	814,412	709,999	470,880
Other current assets		696,113	451,998	901,597
Noncurrent assets:				
Utility plant, net		5,320,740	4,118,775	4,004,646
Promissory notes receivable		155,425	155,425	155,425
Nonutility property and other investments		70,979	63,594	59,132
Deferred charges and long term receivables		244,760	123,492	167,489
Regulatory assets		780,867	861,320	859,513
Acquisition adjustment, net		2,854,578	2,967,258	3,079,939
Total assets	$	10,937,874	9,451,861	9,698,621
Liabilities and net assets:				
Regulatory liability	$	269,476	197,918	368,666
Other current liabilities		1,371,098	878,766	1,100,126
Noncurrent liabilities:				
Long-term debt		6,402,713	6,806,290	6,686,136
Capital lease obligation		2,018,661	1,044,240	1,097,055
Other noncurrent liabilities		613,090	354,857	395,018
Total liabilities		10,675,038	9,282,071	9,647,001
Net assets (deficit):				
Capital assets net of related debt		(190,510)	(417,837)	(340,293)
Unrestricted		453,346	587,627	391,913
Total net assets		262,836	169,790	51,620
Total liabilities and net assets	$	10,937,874	9,451,861	9,698,621

Summary of Revenues, Expenses, and Changes in Net Assets

		Year ended December 31		
		2007	**2006**	**2005**
Electric revenue	$	3,542,555	3,664,976	3,281,186
Operating expenses:				
Operations – fuel and purchased power		1,838,495	2,024,811	1,758,533
Operations and maintenance		847,963	765,569	723,774
General and administrative		37,978	43,082	43,567
Depreciation and amortization		245,632	242,206	237,863
Payments in lieu of taxes		231,490	225,077	222,609
Prior service cost-OPEB's		10,912	—	—
Total operating expenses		3,212,470	3,300,745	2,986,346
Operating income		330,085	364,231	294,840
Other income, net		82,374	85,853	57,518
Interest charges		(319,413)	(331,914)	(332,358)
Change in net assets		93,046	118,170	20,000
Net assets – beginning of year		169,790	51,620	31,620
Net assets – end of year	$	262,836	169,790	51,620

Excess of Revenues over Expenses

The revenues in excess of expenses for the years ended December 31, 2007 and 2006 totaled approximately $93 million and $118 million, respectively, compared with $20 million for 2005.

Revenues

Revenue for the year ended December 31, 2007, decreased approximately $122 million. The decrease is attributable to lower fuel and power supply cost revenues totaling approximately $170 million. This decrease was partially offset by load growth and sales mix estimated to be $31 million, and the positive effects of weather estimated to be approximately $17 million.

Revenue for the year ended December 31, 2006, increased approximately $384 million. The increase is attributable to the higher fuel and purchased power cost revenues totaling approximately $429 million plus higher average pricing totaling approximately $43 million. These increases were partially offset by a reduction of load totaling approximately $10 million, and the negative effects of weather estimated to be approximately $78 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment (FPPCA) that provides for the amount and timing of fuel and purchased power cost recoveries. During 2005, the FPPCA provided for the recovery of fuel and purchased power costs in the period incurred, in amounts sufficient to allow the Authority to earn a financial target of $20 million of excess revenue over expenses as a reserve. In April 2006, the Board approved a modification to the FPPCA increasing the financial target from $20 million to $75 million with a variance of $50 million above or below such amount in each year. Should fuel and purchased power prices change such that LIPA would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can LIPA recover an amount that exceeds its fuel and purchased costs incurred.

Before the effects of the accounting adjustments required by the FPPCA tariff, fuel and purchased power costs for the year ended December 31, 2007, increased approximately $126 million as compared to the same period in 2006 as a result of higher commodity costs totaling approximately $84 million and higher sales volumes totaling approximately $42 million. This increase was offset by the net change in the regulatory liability resulting from the mechanics of the FPPCA totaling approximately $280 million and the recognition in 2006 of a previously deferred unrealized mark-to-market fuel derivative valuation totaling approximately $32 million (of which there were none in 2007). The decrease in the regulatory liability is the result of (i) returning to the customer approximately $197 million of the 2006 deferred excess fuel recoveries, and (ii) the recognition of a $114 million accrual to reflect the liability for fuel recoveries in 2007 in excess of amounts incurred.

Before the effects of the accounting adjustments required by the FPPCA tariff, fuel and purchased power costs for the year ended December 31, 2006, increased approximately $17 million. Commodity costs increased approximately $75 million compared to 2005, partially offset by lower sales volumes totaling approximately $58 million. Additional variations were due to (i) a $198 million accrual to reflect a regulatory liability for fuel recoveries in excess of amounts incurred, (ii) the recognition of previously deferred unrealized mark-to-market fuel derivative valuations totaling approximately $32 million, (iii) the application, in 2005, of customer credits totaling $20 million to partially offset fuel and purchased power costs (no such customer credits were available in 2006), and (iv) lower recoveries of the 2003 deferred fuel costs of approximately $1 million.

Operations and Maintenance Expense (O&M)

Operations and maintenance (O&M) expense for the year ended December 31, 2007, increased $82 million primarily due to the recognition of approximately $54 million of costs associated with a settlement with KeySpan for the funding of certain electric service employee benefit programs dating back to 1998. The remaining O&M increase is due to higher power supply agreement (PSA) costs totaling approximately $13 million as a result of increased capacity charges driven primarily by higher property taxes, higher clean energy costs totaling approximately $8 million, and higher management services agreement (MSA) costs of $10 million primarily due to a billing true-up of approximately $5 million recorded in the current year, higher storm hardening activities of $4 million and higher transmission rents of $5 million, partially offset by various reductions totaling $4 million. These increases were offset by lower storm restoration costs totaling approximately $3 million.

Operations and maintenance expenses increased approximately $42 million for the year ended December 31, 2006 due to increased PSA capacity costs totaling approximately $26 million, higher storm cost accruals totaling approximately $31 million, higher expenses related to the clean energy programs totaling approximately

$5 million and additional expenses from various other items totaling approximately $1 million. These increases were partially offset by lower MSA expenses totaling approximately $21 million, due to the renegotiated annual fee effective during 2006.

General and Administrative Expenses (G&A)

General and administrative expenses decreased approximately $5 million for the year ended December 31, 2007 compared to the year ended December 31, 2006. The decreases were primarily due to an insurance reimbursement of prior year's legal fees totaling approximately $1 million, and cost cutting measures implemented by the Authority's President and Chief Executive Officer which resulted in lower current year legal fees totaling approximately $2 million, lower consulting costs totaling approximately $2 million and lower advertising costs totaling approximately $1 million. These reductions were partially offset by the Authority's adoption of Governmental Accounting Standard No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB No. 45) whereby the Authority recorded a $1 million expense in the current period related to the costs of providing health benefits to employees upon retirement. Prior to adoption of this pronouncement, the Authority recorded such expenses when paid.

General and administrative expenses for the years ended December 31, 2006 and 2005 remained relatively unchanged.

Depreciation and Amortization

For the year ended December 31, 2007, depreciation and amortization increased approximately $3 million due to higher utility plant balances in 2007 when compared to 2006.

For the year ended December 31, 2006, depreciation and amortization increased approximately $4 million due to higher utility plant balances in 2006 when compared to 2005.

Payments in Lieu of Taxes

For the year ended December 31, 2007, payments in lieu of taxes (PILOTs) increased approximately $6 million due to higher property taxes.

For the year ended December 31, 2006, payments in lieu of taxes (PILOTs) increased approximately $2 million due to increased revenue taxes.

Prior Service Cost – OPEBs

The Authority adopted the provisions of GASB No. 45 which, in addition to requiring the recognition of a current period expense, as included in G&A, for providing health benefits to employees upon their retirement. The Authority also recognized the amount incurred in the periods prior to the adoption of this pronouncement which totaled approximately $11 million.

Other Income, Net

Other income decreased approximately $3 million for the year ended December 31, 2007 when compared to the year ended December 31, 2006. This decrease was due to a $6 million charge for the cost of a community benefits package associated with the Caithness generating station, and lower sales of emissions allowance credits of approximately $5 million. These costs were offset by higher investment earnings totaling approximately $8 million resulting from higher investment balances coupled with higher interest rates.

In 2006, other income increased approximately $28 million primarily due to higher investment earnings of approximately $14 million resulting from higher investment balances coupled with higher interest rates, higher income of approximately $12 million from the sale of excess emissions allowances, and lower interest expense totaling approximately $2 million related to New York Independent System Operator (NYISO) prior month's re-bills.

Interest Charges and Credits

Total interest charges decreased approximately $13 million for the year ended December 31, 2007, due primarily to lower interest on counterparty collateral held by LIPA on its fuel derivatives in 2007 (which in 2006 totaled approximately $4 million) and higher allowance for borrowed funds used during construction totaling approximately $3 million. The remaining decrease is due to the lower debt outstanding in 2007 compared to 2006 partially offset by increased interest rates on variable rate debt.

Total interest charges in 2006 were relatively unchanged from 2005; however, interest expense on long-term debt increased approximately $3 million compared to 2005 due to higher rates on variable rate debt. This was offset by higher allowance for borrowed funds used during construction totaling approximately $3 million as a result of higher construction work in progress balances in 2006 compared to 2005.

Cash, Cash Equivalents, and Investments

The Authority's cash, cash equivalents, and investments totaled approximately $814 million, $710 million, and $471 million at December 31, 2007, 2006, and 2005, respectively. The increase from 2006 to 2007 is primarily the result of approximately $81 million received from KeySpan/National Grid related to the Amended and Restated Management Services Agreement and the Settlement Agreement (for a further discussion on the Settlement Agreement, see note 2 of notes to the basic financial statements). The increase from 2005 to 2006 is primarily the result of higher recoveries of fuel and purchased power costs and a new money issuance totaling approximately $295 million. The Authority has maintained a $250 million balance in its Rate Stabilization Fund. The Authority also has the ability to issue up to $300 million of commercial paper notes, $100 million of which is outstanding as of December 31, 2007, 2006 and 2005.

Capital Assets

The Authority continued its investment in transmission and distribution (T&D) upgrades to manage reliability and to enhance capacity needed to meet growing customer demands. For the years ended December 31, 2007 and 2006, capital improvements to the T&D system totaled approximately $295 million and approximately $270 million, respectively. These improvements included interconnection equipment necessary to connect a newly installed undersea cable to the LIPA system, the replacement or upgrade of transformer banks and circuit breakers, new substations, enhanced transmission lines and upgraded command and control equipment.

Regulatory Assets

Regulatory assets decreased approximately $80 million from December 31, 2006 to December 31, 2007. The decrease is the result of: (i) the net change in the mark-to-market valuation on LIPA's fuel derivatives totaling approximately $41 million, and (ii) the recovery of the 2003 deferred excess fuel and purchased power costs totaling approximately $36 million scheduled to be recovered over a ten-year period which began January 1, 2004, in accordance with LIPA's tariff, and (iii) the scheduled recovery of approximately $35 million related to the Shoreham Property Tax Settlement Agreement through a surcharge on billings for electric service to customers residing in Suffolk County (the Shoreham surcharge), which began in June 2003 (as discussed in greater detail in note 3 of notes to basic financial statements). These decreases were partially offset by approximately $32 million of carrying charges on the Shoreham Property Tax Settlement Agreement related credits.

Regulatory assets increased approximately $2 million from December 31, 2005 to December 31, 2006. The increase is the result of: (i) the deferral of the mark-to-market valuation on LIPA's fuel derivatives totaling approximately $41 million, and (ii) approximately $32 million of carrying charges on the Shoreham Property Tax Settlement Agreement related credits, partially offset by, (iii) the recovery of the 2003 deferred excess fuel and purchased power costs totaling approximately $36 million scheduled to be recovered over a ten-year period which began January 1, 2004, in accordance with LIPA's tariff, and (iv) the scheduled recovery of approximately $35 million related to the Shoreham Property Tax Settlement Agreement through a surcharge on billings for electric service to customers residing in Suffolk County (the Shoreham surcharge), which began in June 2003 (as discussed in greater detail in note 3 of notes to basic financial statements).

Regulatory Liabilities

For the year ended December 31, 2007, the Authority recorded a regulatory liability of approximately $269 million which is comprised of (i) approximately $114 million of fuel and purchased power costs recovered in excess of that incurred that is to be returned to the customer through reductions in the FPPCA in 2008, and (ii) the unrealized gains on LIPA's fuel derivatives totaling approximately $155 million.

For the year ended December 31, 2006, the Authority recorded a regulatory liability of approximately $198 million, representing the recovery of fuel and purchased power costs in excess of that incurred which was returned to the customer through reductions to the FPPCA during 2007.

Debt

The Authority's long-term debt, including current maturities is comprised of the following instruments:

Debt

(Thousands of dollars)

	Balance at December 31		
	2007	**2006**	**2005**
General Revenue Bonds	$ 5,791,239	5,982,213	5,826,115
Subordinated Revenue Bonds	879,725	879,725	935,045
Commercial Paper Notes	100,000	100,000	100,000
NYSERDA Notes	155,420	155,420	155,420
	$ 6,926,384	7,117,358	7,016,580

During 2007, debt decreased as a result of scheduled maturities of approximately $219 million partially offset by the accretion of the capital appreciation bonds totaling approximately $28 million.

During 2006, debt increased as a result of the issuance of Electric System General Revenue Bonds Series 2006A through Series 2006F. Of these issuances, Series 2006B totaling approximately $97 million and Series 2006C totaling approximately $198 million were used to reimburse LIPA's treasury for or to fund capital expenditures for system improvements in accordance with the approved capital budget. The remaining issuances totaling approximately $2.221 billion were used to refund existing Authority debt totaling approximately $2.212 billion. Also contributing to the variation was scheduled maturities of approximately $230 million partially offset by the accretion of the capital appreciation bonds totaling approximately $27 million. For a full discussion on the Authority's refunding activities during 2006, see note 9 of notes to the basic financial statements.

Risk Management

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

Whenever the Authority enters into a transaction to mitigate risk, it becomes exposed to an event of nonperformance by the counterparty. To limit its exposure to such risk, the Authority will only enter into derivative transactions with counterparties that have a credit rating of "investment grade" or better. For commodity derivatives the Authority requires collateral for mark to market values above an established credit limit set for each counterparty. At December 31, 2007, the Authority held approximately $3 million of counterparty collateral. At December 31, 2006, the Authority did not hold any counterparty collateral.

The goal of the Authority's risk management program is to reduce the cash impact that energy price volatility and interest rate fluctuations could have on customer bills if not mitigated with derivative products.

In accordance with SFAS No. 133, *Accounting for Derivatives and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, the Authority marks its financial derivatives to market and records unrealized gains and losses.

Fuel and purchased power transactions: – The Authority uses derivative financial instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas, and electricity. These instruments are recorded at their market value. Any unrealized gains and losses are deferred until realized, in accordance with the provisions of the FPPCA. Upon realization, such gains and losses are reflected in income and considered in the determination of the FPPCA. At December 31, 2007, the Authority had unrealized gains on commodity derivatives of approximately $155 million. At December 31, 2006, the Authority had unrealized losses on commodity derivatives of approximately $41 million.

Interest rate transactions: – During 2006, the Authority entered into a floating-to-fixed rate swap agreement for a notional amount of approximately $111 million. This agreement effectively converts the underlying debt obligation from a floating rate to a fixed rate of 4.11%. This agreement became effective July 26, 2006 and is co-terminous with the underlying debt maturity of September 1, 2015.

At December 31, 2007 and 2006, the Authority had a net unrealized market value loss of approximately $196 million and $164 million, respectively, which includes the upfront premiums received totaling approximately $125 million and the reimbursement of administrative costs totaling approximately $24 million related to certain of these derivative transactions. The upfront premiums are being amortized over the life of the underlying swap as interest rate modifiers. The gains and losses resulting from these market values have been deferred, and will be recognized when realized consistent with the Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation* (SFAS No. 71).

Power Supply

The Authority has entered into numerous agreements for capacity and energy necessary to continue to satisfy the increasing energy demand of Long Island, while increasing the diversity of its fuel mix alternatives. The Authority has entered into an agreement to purchase 660 MW of transmission capacity on an undersea high voltage cable between New Jersey and New York. The cable was declared commercially operational on June 29, 2007 thus permitting the Authority to import 660 MW of power from the Pennsylvania, New Jersey and Maryland markets (PJM-ISO or PJM). The Authority has entered into an agreement with the owners of a facility located in PJM to secure long term power capacity supply. This agreement will commence on June 1, 2010.

The Authority also entered into an agreement to acquire 286 MW from a 326 MW plant being constructed on Long Island that is expected to be in operation for the summer of 2009.

During 2006, the Authority completed negotiations to purchase up to 345 MW of additional capacity and varying amounts of energy from a portfolio of facilities located in New England. Service under the agreement commenced in April 2007. Power from this facility is transmitted over an undersea high voltage cable running between Long Island and Connecticut which is currently being operated under the terms of a Bridge Agreement between the cable owners and the Authority. Effective July 2008, the Bridge Agreement will expire and be replaced by a 25-year firm transmission capacity purchase agreement.

For additional information on power purchase agreements and its related accounting treatments, see footnote 3 and 12 of notes to basic financial statements.

Investment Ratings

Below are the Authority's securities as rated by Moody's Investors Service (Moody's), Standard and Poor's Corporation (S&P), and Fitch Investors Services, LP (Fitch):

	Investment Ratings		
	Moody's	**Standard & Poors**	**Fitch**
Senior Lien Debt	A3	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. As a result of the downgrades of certain of those insurers in 2008, certain of the Authority's insured fixed rate and variable rate debt have been downgraded and the market for insured variable rate securities including the Authority's securities has been negatively impacted causing increased interest rates. The Authority is currently in the process of restructuring its insured variable rate portfolio to address this situation.

Possible actions that the Authority may take include the conversion of certain auction rate securities to another interest rate mode, including variable term or fixed rate modes, redemptions or refundings. On January 25, 2008, the Authority issued a redemption notice on $200 million of its auction rate securities, which were redeemed between March 4, and 11, 2008. The Authority used cash on hand to redeem these securities.

Contacting the Long Island Power Authority

This financial report is designed to provide our bondholders, customers, and other interested parties with a general overview of the Authority's finances and to demonstrate its accountability for the funds it receives. If you have any questions about this report or need additional information, contact the Authority at 333 Earle Ovington Blvd., Suite 403, Uniondale, New York 11553, or visit our website at www.lipower.org.

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Balance Sheets

December 31, 2007 and 2006

(Dollars in thousands)

Assets		**2007**	**2006**
Current assets:			
Cash and cash equivalents	$	526,531	501,244
Investments		287,881	208,755
Accounts receivable (net of allowance for doubtful accounts of $19,485)		272,666	269,477
Other accounts receivable		101,146	9,615
Fuel inventory		143,206	138,175
Fuel derivatives		155,153	—
Material and supplies inventory		6,720	6,871
Interest receivable		690	460
Prepayments and other current assets		16,532	27,400
Total current assets		1,510,525	1,161,997
Noncurrent assets:			
Utility plant and property and equipment, net		5,320,740	4,118,775
Promissory notes receivable – KeySpan Energy		155,425	155,425
Nonutility property and other investments		70,979	63,594
Other long term receivables		90,953	—
Deferred unrealized loss – financial derivatives		71,599	33,849
Deferred charges		82,208	89,643
Regulatory assets:			
Shoreham property tax settlement		562,212	565,392
Fuel and purchased power costs recoverable		218,655	295,928
Acquisition adjustment (net of accumulated amortization of $1,240,933 and $1,128,253, respectively)		2,854,578	2,967,258
Total noncurrent assets		9,427,349	8,289,864
Total assets	$	10,937,874	9,451,861

See accompanying notes to basic financial statements.

Liabilities and Net Assets	2007	2006
Current liabilities:		
Short-term debt	$ 100,000	100,000
Current maturities of long-term debt	426,570	218,605
Current portion of capital lease obligation	202,336	121,380
Accounts payable and accrued expenses	530,748	286,738
Regulatory liability – fuel and purchased power costs	269,476	197,918
Fuel derivatives	—	40,673
Accrued payments in lieu of taxes	38,237	43,462
Accrued interest	43,330	42,771
Counterparty collateral	2,900	—
Customer deposits	26,977	25,137
Total current liabilities	1,640,574	1,076,684
Noncurrent liabilities:		
Long-term debt	6,402,713	6,806,290
Capital lease obligation	2,018,661	1,044,240
Asset retirement obligation	91,541	85,086
Deferred credits	286,796	74,367
Deferred credits – financial derivatives	195,500	163,765
Claims and damages	39,253	31,639
Commitments and contingencies (note 12)		
Total noncurrent liabilities	9,034,464	8,205,387
Net assets (deficit):		
Invested in capital assets net of related debt	(190,510)	(417,837)
Unrestricted	453,346	587,627
Total net assets	262,836	169,790
Total liabilities and net assets	$ 10,937,874	9,451,861

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended December 31, 2007 and 2006

(Dollars in thousands)

	2007	2006
Operating revenues – electric sales	$ 3,542,555	3,664,976
Operating expenses:		
Operations – fuel and purchased power	1,838,495	2,024,811
Operations and maintenance	847,963	765,569
General and administrative	37,978	43,082
Depreciation and amortization	245,632	242,206
Payments in lieu of taxes	231,490	225,077
Prior service cost-OPEB’s	10,912	—
Total operating expenses	3,212,470	3,300,745
Operating income	330,085	364,231
Nonoperating revenues and expenses:		
Other income, net:		
Investing income	39,628	31,636
Carrying charges on regulatory asset	32,178	32,438
Other	10,568	21,779
Total other income, net	82,374	85,853
Interest charges and (credits):		
Interest on long-term debt, net	314,725	319,508
Other interest	12,871	17,992
Allowance for borrowed funds used during construction	(8,183)	(5,586)
Total interest charges	319,413	331,914
Total nonoperating revenues and expenses	(237,039)	(246,061)
Change in net assets	93,046	118,170
Total net assets, beginning of year	169,790	51,620
Total net assets, end of year	$ 262,836	169,790

See accompanying notes to basic financial statements.

LONG ISLAND POWER AUTHORITY
(A Component Unit of the State of New York)

Statements of Cash Flows

Years ended December 31, 2007 and 2006

(Dollars in thousands)

		2007	2006
Cash flows from operating activities:			
Received from customers for system sales, net of refunds	$	3,587,244	3,774,745
KeySpan/National Grid Settlement		81,348	—
Other operating revenues received		45,978	41,556
Paid to suppliers and employees:			
Operations and maintenance		(732,899)	(801,155)
Fuel and purchased power		(1,758,301)	(1,754,621)
Payments in lieu of taxes		(338,204)	(327,317)
Collateral on fuel derivative transactions, net		2,900	(232,424)
Net cash provided by operating activities		888,066	700,784
Investing activities:			
Net purchases of investment securities		(79,126)	(168,730)
Earnings received on investments		36,821	29,731
Other		7,730	17,707
Net cash used in provided by investing activities		(34,575)	(121,292)
Cash flows from capital and related financing activities:			
Capital and nuclear fuel expenditures		(300,376)	(297,651)
Proceeds from the issuance of bonds, net of issuance costs		—	2,630,584
Interest paid, net		(309,223)	(281,776)
Redemption of long-term debt		(218,605)	(2,560,260)
Net cash used in capital and related financing activities		(828,204)	(509,103)
Net increase in cash and cash equivalents		25,287	70,389
Cash and cash equivalents at beginning of period		501,244	430,855
Cash and cash equivalents at end of period	$	526,531	501,244
Reconciliation to net cash provided by operating activities:			
Operating income	$	330,085	364,231
Adjustments to reconcile excess of operating income to net cash provided by operating activities:			
Depreciation and amortization		245,632	242,206
Nuclear fuel burned		5,456	5,259
Shoreham surcharges (credits), net		35,358	35,362
Provision for claims and damages		40,552	43,301
Accretion of asset retirement obligation		6,455	4,699
Other, net		3,157	3,667
Changes in operating assets and liabilities:			
Accounts receivable, net		(31,797)	88,483
Fuel and material and supplies inventory		(4,880)	(33,029)
Deferred fuel and purchased power costs		(46,994)	265,773
Counterparty collateral		2,900	(232,424)
Accounts payable and accrued expenses		302,142	(86,744)
Net cash provided by operating activities	$	888,066	700,784

See accompanying notes to basic financial statements.

(1) Basis of Presentation

The Long Island Power Authority (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 LIPA Act). As such, it is a component unit of the State and is included in the State's annual financial statements.

The Authority's reporting entity is comprised of itself and its operating subsidiary the Long Island Lighting Company (LILCO), a wholly owned subsidiary of 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.

As the Authority holds 100% of the common stock of LIPA and substantially controls the operations of LIPA, under Government Accounting Standard Board Statement No. 14, *The Financial Reporting Entity*, LIPA is considered a blended component unit of the Authority and the assets, liabilities and results of operations are consolidated with the operation of the Authority for financial reporting purposes.

The Authority and its blended component unit, LIPA, are referred to collectively, as the "Company" in the financial statements. All significant transactions between the Authority and LIPA have been eliminated.

(2) Nature of Operations

LIPA, as owner of the transmission and distribution system located in New York State Counties of Nassau and Suffolk (with certain limited exceptions) and a small portion of Queens County known as the Rockaways (Service Area), is responsible for supplying electricity to customers within the service area. To assist LIPA in meeting these responsibilities, LIPA contracted with KeySpan Energy Corporation (KeySpan) or its affiliates to provide: operations and management services related to the transmission and distribution system through a management services agreement (MSA); capacity and energy from the fossil fired generating plants of KeySpan, formerly owned by LILCO, through a power supply agreement (PSA); and, energy and fuel management services through an energy management agreement (EMA) (collectively; the Operating Agreements). Through these contracts, LIPA pays KeySpan directly for these services and KeySpan, in turn, pays the salaries of its employees and fees of its contractors and suppliers. In 2007 and 2006, LIPA paid to KeySpan approximately $2 billion each year under the operating agreements, which includes all fees under such agreements, reimbursement for various taxes and PILOTS, certain fuel and purchase power costs, capital projects, conservation services, research and development and various other expenditures authorized by the Company. On August 24, 2007, National Grid plc, a company organized under the laws of England and Wales completed its acquisition of KeySpan.

In January 2006 LIPA entered into definitive agreements with certain of the KeySpan Subs to amend the MSA and certain other Operating Agreements. The Amended & Restated MSA (i) provides a simpler "fee for service" contract and (ii) establishes 18 service level metrics which KeySpan must achieve or be subject to penalties and (iii) extends the term of the MSA to December 31, 2013. LIPA also entered into a Settlement Agreement, dated January 1, 2006 (the 2006 Settlement Agreement) with KeySpan and certain of the KeySpan Subs to resolve certain outstanding disputes. Under the Settlement Agreement, KeySpan agreed to provide LIPA approximately $120 million in payments or credits for outstanding items which has been included in deferred credits. The New York State Comptroller approved these agreements in 2007.

LIPA also entered into option agreements with KeySpan Generation LLC (GENCO) which provides LIPA with an option, exercisable until May 31, 2008, to acquire the Barrett steam and combustion turbine units and/or the Far Rockaway plants for book value at the time of sale. National Grid also granted LIPA options to purchase, at 1.25 times book value at the time of sale, the combustion turbines at the Shoreham and Wading River sites which expires May 31, 2008 (the Purchase Option Agreement). LIPA also obtained a right of first refusal to purchase, on substantially the same terms as offered, all (but not less than all) GENCO generating facilities which GENCO may decide to sell to a foreign or foreign-controlled entity during the term of the PSA (Right of First Refusal). In the event that LIPA acquires either or both of such plants, LIPA and KeySpan have agreed that KeySpan, acting through a subsidiary to be designated, will operate and maintain such plant(s) until it is retired or repowered.

In consideration for LIPA's waiver of its rights under the change of control provisions in the Operating Agreements as a result of the National Grid acquisition of KeySpan, LIPA and National Grid reached an agreement (the Agreement and Waiver). Under the Agreement and Waiver, National Grid agreed to pay LIPA approximately $91 million over a period of seven years representing LIPA's guaranteed share of the synergy savings as a result of the National Grid acquisition of KeySpan. In addition, National Grid agreed to provide LIPA $25 million in incremental consideration, to be used for various matters.

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 service to its customers. 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 Administrative Services Agreement.

(3) 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 nongovernmental entities (i.e., pronouncements of the Financial Accounting Standards Board) that do not conflict with GASB pronouncements.

The operations of the Company are presented as an enterprise fund following the accrual basis of accounting in order to recognize the flow of economic resources. Under this basis, revenues are recognized in the period which they are earned and expenses are recognized in the period in which they are incurred.

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, as of December 31, 2007, the Company estimates that approximately $51 million of net fuel and purchased power payable, approximately $72 million of net unrealized deferred losses on the Company's financial derivative transactions, and the acquisition adjustment totaling approximately $2.8 billion would be considered for impairment.

Utility Plant and Property and Equipment

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 borrowed 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, and Clean Energy initiatives. Investments' carrying value is reported at fair market value. See footnote 8 for a further discussion.

Fuel Inventory

Under the terms of the EMA and various Power Purchase Agreements, LIPA owns the fuel oil used in the generation of electricity at the facilities under contract to LIPA. 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.

Fuel Derivatives

The Authority uses derivative instruments to protect its customers from market price fluctuations for the purchase of fuel oil, natural gas and electricity. These instruments are recorded at their market value. Any unrealized gains or losses are deferred until realized, in accordance with the provisions of the fuel and purchased power cost adjustment (FPPCA). At December 31, 2007, the Authority's commodity derivatives had a positive mark-to-market value of approximately $155 million. At December 31, 2006, the Authority's commodity derivatives had a negative mark-to-market value of approximately $41 million.

Material and Supplies Inventory

This represents LIPA's share of material and supplies inventory needed to support the operation of the Nine Mile Point 2 (NMP2) nuclear power station.

Promissory Note Receivable

As part of the 1998 Merger, KeySpan issued promissory notes to LIPA of approximately $1.048 billion. As of December 31, 2007 and 2006, approximately $155 million remained outstanding, respectively. The fair market value of the note at December 31, 2007 and 2006 is approximately $156 million and $158 million, respectively. The interest rates 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 payments to LIPA thirty days prior to the corresponding payment due dates, and LIPA transfers those amounts to the debt holders in accordance with the original debt repayment schedule.

Nonutility Property and Other Investments

The Authority's nonutility property and other investments consist primarily of the Nine Mile Point 2 Decommissioning Trust Fund (the Trusts). At December 31, 2007 and 2006, the value of the Trusts was approximately $71 million and $63 million, respectively.

Other Long Term Receivables

This represents the net present value of synergy savings due from National Grid resulting from the purchase of KeySpan by National Grid as discussed in footnote 2. LIPA also recognized a receivable related to the reimbursement of costs to construct the interconnection facilities related to the Neptune cable, which is to be paid to LIPA over a period of 20 years.

Deferred Unrealized Gains (Losses) – Financial Derivatives

The Authority uses derivative instruments to manage the cash flow impact of interest rate changes on its customers, earnings and cash flows. Under the provisions of SFAS No. 133, *Accounting for Derivatives and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, the Authority is required to recognize the fair value of all derivative instruments as either an asset or liability on the balance sheet with an offsetting gain or loss recognized. 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.

As the Authority is subject to the provisions of SFAS No. 71, all such gains and losses are deferred until realized.

Deferred Charges

Deferred charges represent primarily the unamortized balance of costs incurred to issue long-term debt. Such amounts are amortized to interest expense over the life of the debt issuance to which they relate. Also included in deferred charges are amounts incurred by the Authority related to various energy projects, whose amortization is charged to fuel and purchased power costs over the period of benefit (the life of the related Power Purchase Agreement).

Regulatory Assets

Shoreham Property Tax Settlement (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. As required under the terms of the agreement, the Authority was required to issue $457.5 million of rebates and credits to customers over the five-year period which began May 29, 1998. In order to fund such rebates and credits, the Authority used the proceeds from the issuance in May 1998 of its Capital Appreciation Bonds, Series 1998A Electric System General Revenue Bonds totaling approximately $146 million and the issuance in May 2000 of approximately $325 million of Electric System General Revenue Bonds, Series 2000A.

As provided under the Settlement, beginning in June 2003, LIPA's Suffolk County customers' bills include a surcharge (the Suffolk Surcharge) to be collected over the succeeding approximate 25 year period to repay the Authority for debt service and issuance costs on the bonds issued by the Authority to fund the Settlement as well as its cost of pre-funding certain rebates and credits.

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 property tax settlement regulatory asset as of December 31, 2007 and 2006 was approximately $562 million and

$565 million, respectively. The balance represents costs recorded from 1998 through 2004 including rebates and credits issued to customers, costs of administering the program plus annual debt service costs on the bonds identified above less surcharges collected since May 2003 totaling approximately $161 million.

Fuel and Purchased Power Costs Recoverable

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment (FPPCA) that provides for the recovery of fuel and purchased power costs in the period incurred, in amounts sufficient to allow the Authority to earn a financial target of $75 million with a variance of $50 million above or below such amount in each year. Should fuel and purchased power prices change such that LIPA would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can LIPA recover an amount that exceeds its fuel and purchased power costs incurred.

Prior to 2004, LIPA deferred a portion of its excess fuel and purchased power costs and collected those costs in subsequent years. In order to transition to a current period recovery method, LIPA deferred, in 2003, approximately $365 million of unrecovered fuel and purchased power costs to be recovered over a 10-year period beginning January 1, 2004. As of December 31, 2007 and 2006, the uncollected balance of this deferral totaled approximately $219 million and $255 million, respectively.

The Authority uses derivative instruments to protect its customers, earnings and cash flows from significant price fluctuations for the purchase of fuel oil, natural gas and electricity. As the Authority is subject to the provisions of SFAS No. 71, gains and losses on such derivatives are deferred until realized.

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 are recorded at fair market value as of December 31, 2007 and 2006.

Capitalized Lease Obligations

Capitalized lease obligations represent the net present value of various contracts for the capacity and/or energy of certain generation and transmission facilities in accordance with Emerging Issues Task Force No. 01-08, *Determining if Whether an Arrangement Contains a Lease*, and Statement of Financial Accounting Standards (SFAS) No. 13, *Accounting for Leases*. Upon satisfying the capitalization criteria, the net present value of the contract payments is included in both Utility Plant and Capital Lease Obligations.

LIPA recognizes in Fuel and Purchased Power expense an amount equal to the contract payment 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 asset and obligation at each month end.

For a further discussion on the capitalization of capacity and/or energy contracts, see note 12.

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.

Deferred Credits – Financial Derivatives

Represents the net amount that the Authority would be required to pay its counterparties to terminate these financial derivative instruments as of December 31, 2007 and 2006. The amount shown includes unamortized balance of cash premiums received by the Authority at the time of entering into these instruments. The Authority is amortizing such premiums ratably over the life of the instrument.

Claims and Damages

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

Revenues

Operating revenues are comprised of cycle billings for electric service rendered to customers, based on meter reads, and the accrual of revenues for electric service rendered to customers not billed at month-end. All other revenue not meeting this definition is reported as nonoperating revenue when service is rendered. For the years ended December 31, 2007 and 2006, LIPA received approximately 52% of its revenues from residential sales, 45% from sales to commercial and industrial customers, and the balance from sales to public authorities and municipalities.

Depreciation and Amortization

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. The average composite depreciation rate is 2.89%.

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.

The following estimated useful lives and capitalization thresholds are used for utility property:

Category	Useful life	Capitalization threshold
Generation – nuclear	37 – 38 years	$ 200
Transmission and distribution	23 – 46 years	200
Common	4 – 42 years	200
Nuclear fuel in process and in reactor	6 years	200
Generation assets under capital lease	15 – 25 years	—

Payments-in-Lieu-of-Taxes

The Company makes 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. In addition, the Authority has entered into various PILOT arrangements for property it owns, upon which merchant generation and transmission is built.

Allowance for Borrowed Funds Used During Construction

The allowance for borrowed funds used during construction (AFUDC) is the net cost of borrowed funds used for construction purposes. AFUDC is not an item of current cash income. AFUDC is computed monthly on a portion of construction work in progress, and is shown as a net reduction in interest expense.

Income Taxes

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

Regulatory Liability – Fuel and Purchased Power Costs

Regulatory liabilities represent amounts that are expected to be refunded to customers through the ratemaking process. In accordance with the FPPCA, LIPA must return any FPPCA revenues it recovers in excess of the fuel and purchased power costs it incurs. Any such over recoveries are recognized as regulatory liabilities. In addition, in accordance with the FPPCA unrealized mark to market gains on commodity derivatives are deferred and recognized in the period realized.

Asset Retirement Obligation

The Authority adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*. An Asset Retirement Obligation (ARO) exists when there is a legal obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, or development and/or normal operation of the asset. LIPA, as an 18% owner of Nine Mile Point 2 (NMP2) Nuclear Power Station, has a legal obligation associated with its retirement. This obligation is offset by the capitalization of the asset which is included in “Utility plant and property and equipment, net”. As of December 31, 2007 and 2006, the NMP2 asset retirement obligation totaled approximately $86 million and $77 million, respectively.

Additionally, during 2005, FASB Summary of Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*—an interpretation of SFAS No. 143, *Accounting for Asset Retirement Obligations*, was issued. This Interpretation clarifies that the term conditional asset retirement obligation as used in SFAS No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. As of December 31, 2007 and 2006 the asset retirement obligation for LIPA's utility assets totaled approximately $6 million and $8 million, respectively. The decrease in 2007 from 2006 is attributable to the removal and remediation of an undersea high voltage cable between Long Island and Connecticut in accordance with an administrative consent order. Please see note 13 for a full discussion of this remediation effort.

Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that there is a significant unexpected decline in the service utility of a capital asset. The service utility of a capital asset is the usable capacity that at acquisition was expected to be used to provide service. An impairment is measured using one of three approaches that best reflects the decline in service utility. Assets to be disposed of and assets held for sale are reported at the lower of the carrying amount or fair value less costs to sell.

Use of Estimates

The accompanying financial statements were prepared in conformity with U.S. generally accepted accounting principles 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 year amounts have been reclassified in the financial statements to conform to the current year presentation.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This Statement relates to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under Statement No. 133. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The transition adjustment, measured as the difference between the carrying amounts and the fair values of those financial instruments at the date the Statement is initially applied, should be recognized as a cumulative-effect adjustment to the opening balance of net assets. However, the adoption of this statement is expected to have no material impact on the Authority's financial position or results of operations as all its mark to markets of its derivatives are deferred until realized.

(Continued)

(4) Risk Management

The Authority is routinely exposed to commodity and interest rate risk. In order to mitigate such exposure, the Authority formed an Executive Risk Management Committee to provide executive management oversight by the Authority's energy risk management activities.

Fuel and purchased power transactions: The Authority uses derivative financial instruments as detailed in the table below:

Fuel Derivative Transactions

Type of contract			**Duration**		**Volume per month**
Oil contracts (volumes in barrels):					
	Options				
	Put	Long	Jan 08 – Dec 08		120,000 – 462,000
	Put	Short	Jan 08 – Jul 10	(a)	5,000 – 394,000
	Call	Long	Jan 08 – Jul 10	(a)	5,000 – 394,000
	Swap	Long	Jan 08 – Dec 10		19,000 – 435,000
Gas Transactions (volumes in decatherms):					
	Put	Long	—		—
	Put	Short	Jan 08 – Aug 10	(b)	70,000 – 3,952,500
	Call	Long	Jan 08 – Aug 10	(b)	70,000 – 3,952,500
	Swap	Long	Jan 08 – Dec 10		70,000 – 4,452,000
Basis transactions (volumes in decatherms):					
	Swap	Long	Feb 08 – Mar 09		300,000 – 2,165,000
Off-Peak Power (volumes in MW hours):					
	Swap	Long	Jan 08 – Dec 10		18,400 – 265,200
On-Peak Power (volumes in MW hours):					
	Swap	Long	Jan 08 – Jan 11		8,400 – 319,200

(a) No ownership January – March 2010
(b) No ownership November 2009

Interest Rate Transactions: The Authority has entered into several interest rate swap agreements with several counterparties to modify the effective interest rates on outstanding debt as detailed below (thousands of dollars):

Notional amount	Termination date	Type of swap		December 31, 2007 Mark to market	December 31, 2007 Deferred gain (loss)
$ 150,000	4/1/2025	Floating to Fixed		$ (12,543)	(12,543)
100,000	4/1/2025	Floating to Fixed		(8,830)	(8,830)
587,225	12/1/2029	Floating to Fixed	(a)	(137,019)	(49,023)
110,715	9/1/2015	Floating to Fixed		(5,213)	(5,213)
502,090	8/15/2033	Basis Swap	(c)	(15,165)	(686)
251,045	8/15/2033	Basis Swap	(d)	(7,690)	(451)
251,045	8/15/2033	Basis Swap	(d)	(7,749)	(509)
116,000	5/1/2033	Fixed to Floating		6,217	6,217
116,000	5/1/2033	Floating to Fixed	(b)	(7,508)	(561)
Total				$ (195,500)	(71,599)

(a) The Authority received an upfront premium totaling approximately $106 million, of which $24.4 million represented reimbursement of administrative costs.

(b) The Authority received an upfront premium totaling approximately $8 million.

(c) The Authority received an upfront premium totaling approximately $17.5 million.

(d) The Authority received an upfront premium totaling approximately $8.75 million.

(5) Rate Matters

Under current New York State law, the Authority is empowered to set rates for electric service in the Service Area without the approval of the New York State Public Service Commission (PSC) or any other state regulatory body. However, the Authority has agreed, in connection with the approval of the 1998 merger of the Authority and LILCO (d/b/a LIPA) 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 base 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 Property Tax Settlement, but adjusted to reflect emergency conditions and extraordinary unforeseeable events, including a precipitous rise in oil prices).

For purposes of determining compliance with the 2.5% and 14% PACB conditions described in the preceding paragraph, the Authority has interpreted the PACB conditions as allowing the exclusion of increases in the cost of electricity paid by the Authority’s customers related to pass through adjustments, such as the FPPCA.

The LIPA 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: (i) the FPPCA, to allow for adjustments to customers' bills to reflect changes in the cost of fuel and purchased power and related costs; (ii) a PILOTS recovery rider, which allows for rate adjustments to accommodate PILOTS; and (iii) a rider providing for the recovery of costs associated with the Shoreham Property Tax Settlement.

For a further discussion on rate matters, see note 13.

(6) Utility Plant and Property and Equipment

The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2007 (thousands of dollars):

	Beginning balance	Additions	Deletions	Ending balance
Capital assets, not being depreciated:				
Land	$ 12,851	2,861	—	15,712
Retirement work in progress	12,693	21,783	9,667	24,809
Construction in progress	176,061	286,649	254,368	208,342
Total capital assets not being depreciated	201,605	311,293	264,035	248,863
Capital assets, being depreciated:				
Generation – nuclear	711,340	3,086	3,170	711,256
Transmission and distribution	2,661,555	218,685	8,674	2,871,566
Common	20,254	997	158	21,093
Nuclear fuel in process and in reactor	59,371	13,387	—	72,758
Office equipment, furniture, and leasehold improvements	3,704	262	—	3,966
Generation and transmission assets under capital lease	1,347,829	1,127,073	—	2,474,902
Total capital assets being depreciated	4,804,053	1,363,490	12,002	6,155,541
Less accumulated depreciation for:				
Generation – nuclear	185,747	25,512	12	211,247
Transmission and distribution	462,698	106,627	14,765	554,560
Common	4,580	2,124	157	6,547
Nuclear fuel in process and in reactor	48,721	5,456	—	54,177
Office equipment, furniture, and leasehold improvements	2,928	300	—	3,228
Generation assets under capital lease	182,209	71,696	—	253,905
Total accumulated depreciation	886,883	211,715	14,934	1,083,664
Net value of capital assets, being depreciated	3,917,170	1,151,775	(2,932)	5,071,877
Net value of all capital assets	$ 4,118,775	1,463,068	261,103	5,320,740

In 2007, depreciation expense related to capital assets was approximately $133 million.

The following schedule summarizes the utility plant and property and equipment of the Authority as of December 31, 2006 (thousands of dollars):

	Beginning balance	Additions	Deletions	Ending balance
Capital assets, not being depreciated:				
Land	$ 12,174	677	—	12,851
Retirement work in progress	21,168	17,610	26,085	12,693
Construction in progress	90,430	283,380	197,749	176,061
Total capital assets not being depreciated	123,772	301,667	223,834	201,605
Capital assets, being depreciated:				
Generation – nuclear	703,354	8,000	14	711,340
Transmission and distribution	2,491,420	185,763	15,628	2,661,555
Common	17,455	3,590	791	20,254
Nuclear fuel in process and in reactor	57,687	1,691	7	59,371
Office equipment, furniture, and leasehold improvements	3,496	213	5	3,704
Generation assets under capital lease	1,347,829	—	—	1,347,829
Total capital assets being depreciated	4,621,241	199,257	16,445	4,804,053
Less accumulated depreciation for:				
Generation – nuclear	159,233	26,528	14	185,747
Transmission and distribution	402,987	101,525	41,814	462,698
Common	3,141	2,230	791	4,580
Nuclear fuel in process and in reactor	43,462	5,259	—	48,721
Office equipment, furniture, and leasehold improvements	2,583	345	—	2,928
Generation assets under capital lease	128,961	53,248	—	182,209
Total accumulated depreciation	740,367	189,135	42,619	886,883
Net value of capital assets, being depreciated	3,880,874	10,122	(26,174)	3,917,170
Net value of all capital assets	$ 4,004,646	311,789	197,660	4,118,775

In 2006, depreciation expense related to capital assets was approximately $130 million.

(Continued)

(7) 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, operated by Constellation Nuclear LLC (Constellation).

LIPA's share of the rated capability of NMP2 is approximately 207 megawatts (MW). LIPA's net utility plant investment, excluding nuclear fuel, was approximately $500 million and $526 million as of December 31, 2007 and 2006, 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 an 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 maintains on-site nuclear oversight representation to provide additional support to protect LIPA's interests.

NMP2 License Renewal

In October 2006, the Nuclear Regulatory Commission (NRC) granted a license extension for the Nine Mile Point 2 facility for an additional 20 years, extending the license through October 2046.

In January 2007, LIPA's Board of Trustees agreed to participate in the extended license.

Nuclear Plant Decommissioning

LIPA is making provisions for decommissioning costs for NMP2 based on a site-specific study performed in 1995, as updated by LIPA's engineering consultants. LIPA's share of the total decommissioning costs for both the contaminated and noncontaminated portions is estimated to be approximately $86 million and $77 million as of December 31, 2007 and 2006, respectively, and is included in the balance sheet as a component of the asset retirement obligation. LIPA maintains a trust fund for its share of the decommissioning costs of NMP2, which as of December 31, 2007 and 2006, had an approximate value of $71 million and $66 million, respectively. Through continued deposits and investment returns being maintained within these trusts, the Company believes that the value of these trusts in 2046 will 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 President signed into law the Terrorism Risk Insurance Act (TRIA) of 2002, which was extended by the Terrorism Risk Insurance Extension Act of 2005 and the Terrorism Risk Insurance Program Reauthorization Act of 2007. Under the TRIA, property and casualty insurance companies are required to offer insurance for losses resulting from Certified acts of terrorism. Certified acts of terrorism are determined by the Secretary of the Treasury, in concurrence with the Secretary of State and Attorney General, and primarily are based upon the occurrence of significant acts of international terrorism as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion. The nuclear property and accidental outage insurance programs, as discussed later in this section provide coverage for certified acts of terrorism.

Losses resulting from noncertified acts of terrorism are covered as a common occurrence, meaning that if noncertified 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 104 presently licensed nuclear reactors in the United States to a retrospective assessment of up to $100.6 million for each nuclear incident, payable at a rate not to exceed $15 million per year. LIPA's interest in NMP2 could expose it to a maximum potential loss of $18.1 million, per incident, through assessments of up to $2.7 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. The policy provides a single industry aggregate limit of $200 million for occurrences of radiation injury claims against all those insured by this policy prior to January 1, 2003 and $300 million for occurrences of radiation injury claims against all those insured by this policy on or after January 1, 2003.

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 additional protection (including decontamination costs) of $1.25 billion of stand alone excess property insurance and a $1.0 billion shared excess policy for Nine Mile Point through the Nuclear Electric Insurance Limited (NEIL). Each member of NEIL, including LIPA, is also subject to retrospective premium adjustments in the event losses at other member facilities exceed accumulated reserves. For its share of NMP2, LIPA could be assessed up to approximately $3.8 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 $630,000 per week for the first 52 weeks, reduced to $504,000 per week for an additional 110 weeks for the purchase of replacement power, with a maximum limit of $88.2 million over a three year period.

(8) Cash, and Cash Equivalents and Investments

The Authority and LIPA each have distinct investment policies to manage the risks associated with each of their investment objectives.

(a) Authority

The Authority's investments are managed by an external investment manager and consist of two accounts; the Operating Fund and the Rate Stabilization Fund. The Operating Fund is managed to meet the liquidity needs of the Authority and the Rate Stabilization Fund is managed to maximize the return on investment. The Authority must maintain a minimum balance of $150 million in the Rate Stabilization Fund as required by the Authority's bond covenants, however, the Authority has set an informal policy of maintaining a minimum balance of $250 million. Additionally, the Authority is required to maintain compensating balances of $1.2 million.

The Authority's investment policy places limits on investments by issuer and by security type and addresses various risks described below. The Board of Trustees of the Authority may also specifically authorize, as it deems appropriate, other investments that are consistent with the Authority's investment objective. The Authority reviews its investment policy on an annual basis to ensure continued effectiveness.

Credit Risk

The Authority's permissible investments and related minimum credit ratings include U.S. Treasury and Federal Agency obligations (AAA), repurchase agreements (A-1), bankers' acceptances (AA- or Aa3), commercial paper (A1 or P-1), corporate notes (AA- or Aa3), master notes (AA- or Aa3) and asset backed securities (AAA), certificates of deposit (AA- or Aa3), mutual funds (AAAm or AAAm-G), investment contracts (AA- or Aa3, municipal obligations (AA- or Aa3), and variable rate notes (no credit rating limit). The Authority's investment policy prohibits investments involving complex derivatives, reverse repurchase agreements, and short selling and arbitrage related investment activity.

Concentration of Credit Risk

To address this risk, the Authority's investment policies have established limits such that no more than 5% of the investment portfolio may be invested in the securities of any one issuer with the exception of U.S. Treasury Obligations (100% maximum), each Federal agency (35% maximum), repurchase agreements counterparties (lesser of 10% or $50 million), mutual funds (50% maximum) and investment contracts (10% maximum).

Custodial Credit Risk

The Authority believes that custodial credit risk related to its investments to be minimal as its guidelines stipulate that deposits and investments be held by a third-party custodian who may not otherwise be a counter-party to the transactions, and that all securities are free and clear of any lien and held in the name of the Authority.

Custodial credit risk for cash deposits is the risk that in the event of a bank failure, the Authority's deposits may not be returned. The Authority's policy to address this risk requires that the custodian or depository bank have a long term credit rating of Aa3/AA. Custodians or depository banks not meeting this credit rating are required to provide collateral.

As of December 31, 2007 and 2006, the Authority had deposits of $29 million and $21 million respectively, of which approximately $18 million and $3 million were not collateralized or were uninsured. Uncollateralized balances were primarily the result of amounts temporarily held pending investment or disbursement. Collateral on the remaining deposits is held in the name of the Authority and range from 102% to 105% of the deposit balances.

Interest Rate Risk

The Authority's investment policy states that investments have maturities of 12 months or less, generally. Investment maturities may exceed 12 months provided that the maturity does not exceed the expected disbursement date of those funds, the total average portfolio maturity is one year or less and no individual maturity exceeds three years, with the exception of U.S. Government obligations and investment contracts. The duration of the Authority's investment maturities are detailed in the chart below.

As of December 31, 2007 and 2006 the Authority had the following investments and maturities (amounts in thousands):

Investment type	2007 Fair value	Percent of portfolio	Investment maturities: Less than 3 months	3 months to 1 year	Over 1 year
Short term discount notes:					
Commercial paper	$ 455,680	56%	$ 194,620	261,060	—
Federal agencies	239,969	29	220,155	19,814	—
Master notes/money markets	90,000	11	90,000	—	—
Cash and collateralized deposits	28,763	4	21,756	4,005	3,002
Total	$ 814,412	100%	$ 526,531	284,879	3,002

Investment type	2006 Fair value	Percent of portfolio	Investment maturities: Less than 3 months	3 months to 1 year	Over 1 year
Short term discount notes:					
Commercial paper	$ 374,283	53%	$ 167,623	206,660	—
Federal agencies	224,379	32	224,379	—	—
Master notes/money markets	90,000	13	90,000	—	—
Cash and collateralized deposits	21,337	2	19,242	—	2,095
Total	$ 709,999	100%	$ 501,244	206,660	2,095

(b) LIPA

LIPA maintains a separate investment policy applicable to the long term investments in the Nuclear Decommissioning Trust (NDT) which is held to meet LIPA's obligation with respect to the eventual decommission of LIPA's 18% interest in the Nine Mile Point 2 nuclear facility. LIPA guidelines detail permissible investments and portfolio restrictions. LIPA reviews its investment policy at least annually to ensure that the value in the trusts in 2046, (the year in which decommissioning activities are scheduled to begin) will be sufficient to meet its decommissioning obligations.

Credit Risk

LIPA's guidelines minimize the risk by limiting permissible investments to include; obligations of the U.S. Government and its Agencies, corporate or other obligations with an A or better rating, mortgage obligations rated AA or higher, commercial paper with a rating of A1 or P1, certificates of deposit, Eurodollar certificates of deposit and bankers acceptances of domestic banks with A+ rating or better, short term money market investment accounts that conform to the aforementioned permissible investments, portfolio funds of securities designed to replicate the overall market measured by the S&P 500 Index, and futures contracts on the S&P 500 Index in the futures markets. The Board of Trustees authorized the use of equity investments as a permissible vehicle within this portfolio in 2004 and limited the maximum exposure to 35%. The Nuclear Decommissioning Trust investment portfolio must be rebalanced quarterly at plus or minus 5% for equity investments. Fixed income securities held in the portfolio must maintain an average credit rating of AA or better with no more than 30% of the portfolio invested in notes and bonds rated A and no more than 20% of the portfolio invested in municipal securities.

Concentration of Credit Risk

To address this risk, LIPA's investment policies have established limits such that no more than 5% of the portfolio may be invested in the securities of any one issuer with the exception of U.S. Government and its agencies securities. In addition, no more than 25% of the portfolio may be invested in securities of issuers in the same industry.

Custodial Credit Risk

LIPA does not have a policy relative to custodial credit risk of its deposits, however, as a practical matter, LIPA defers to the policies of the Authority, as discussed above.

Interest Rate Risk

Due to the long term nature of the NDT asset, interest rate risk is managed to track the Lehman Brothers Government/Credit Bond Index. The portfolio's duration is required to fall within a range of 20% below the duration of the index and 10% above the duration of the index.

As of December 31, 2007 and 2006 LIPA had the following investments (amounts in thousands):

Investment type		2007 Fair value	Percent of portfolio
Corporate notes and bonds	$	14,529	21%
Mortgage obligations		6,367	9
U.S. Government and its agencies obligations		35,680	50
Money market		34	—
Equity securities		14,238	20
Total	$	70,848	100%

Investment type		2006 Fair value	Percent of portfolio
Corporate notes and bonds	$	18,987	28%
Mortgage obligations		5,725	9
U.S. Government and its agencies obligations		23,613	36
Money market		4,410	7
Equity securities		13,504	20
Total	$	66,239	100%

The overall duration of the three individual accounts averaged 5.2 and 4.7 years at December 31, 2007 and 2006, respectively, and is within the limits described by LIPA's investment guidelines.

(9) Long-Term and Short-Term Debt

The Authority financed the cost of the merger and the refinancing of certain of LILCO's outstanding debt by issuing 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.

All of the Authority's 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.

The Company's bond and note indebtedness and other long-term liabilities as of December 31, 2007 are comprised of the following obligations (thousands of dollars):

	Beginning balance	Accretion/ additions	Maturities	Refundings	Ending balance	Due within one year
Authority debt:						
Electric system general revenue bonds:						
Series 1998A	$ 515,108	7,554 (a)	79,110	—	443,552	82,955
Series 1998B	382,560	—	111,350	—	271,210	116,725
Series 2000A	345,980	20,077 (a)	—	—	366,057	—
Series 2001A	165,175	—	—	—	165,175	—
Series 2001B-K	500,000	—	—	—	500,000	150,000
Series 2001L-P	200,000	—	—	—	200,000	50,000
Series 2003A	53,470	—	15,795	—	37,675	17,780
Series 2003B	288,015	—	8,165	—	279,850	8,495
Series 2003C	256,000	—	—	—	256,000	—
Series 2003D-O	587,225	—	—	—	587,225	—
Series 2004A	200,000	—	—	—	200,000	—
Series 2006A	839,245	—	—	—	839,245	—
Series 2006B	96,955	—	—	—	96,955	—
Series 2006C	198,020	—	—	—	198,020	—
Series 2006D	328,770	—	590	—	328,180	615
Series 2006E	507,600	—	—	—	507,600	—
Series 2006F	518,090	—	3,595	—	514,495	—
Subtotal	5,982,213	27,631	218,605	—	5,791,239	426,570
Electric system subordinate revenue bonds:						
Series 1-3	525,000	—	—	—	525,000	—
Series 7	250,000	—	—	—	250,000	—
Series 8	104,725	—	—	—	104,725	—
Subtotal	879,725	—	—	—	879,725	—
LIPA Debt:						
NYSERDA notes	155,420	—	—	—	155,420	—
Net unamortized discounts/premiums and deferred amortization	7,537	(4,638)	—	— (b	2,899	—
Total bonds and notes, net of unamortized discounts/premiums	$ 7,024,895	22,993	218,605	—	6,829,283	426,570
Other long-term liabilities:						
Deferred credits	$ 74,367	213,871	1,442	—	286,796	—
Claims and damages	31,639	40,552	32,938	—	39,253	—
Capital lease obligation	1,165,620	1,127,073	71,696	—	2,220,997	202,336
Total other long-term liabilities	$ 1,271,626	1,381,496	106,076	—	2,547,046	202,336

(a) Represents accretion of capital appreciation bonds
(b) Represents normal amortization

The Company's bond and note indebtedness and other long-term liabilities as of December 31, 2006 are comprised of the following obligations (thousands of dollars):

	Beginning balance	Accretion/ additions		Maturities	Refundings		Ending balance	Due within one year
Authority debt:								
Electric system general revenue bonds:								
Series 1998A	$ 2,092,925	7,768	(a)	75,810	1,509,775		515,108	79,110
Series 1998B	711,580	—		—	329,020		382,560	111,350
Series 2000A	327,005	18,975	(a)	—	—		345,980	—
Series 2001A	300,000	—		—	134,825		165,175	—
Series 2001B-K	500,000	—		—	—		500,000	—
Series 2001L-P	316,000	—		—	116,000		200,000	—
Series 2003A	67,400	—		13,930	—		53,470	15,795
Series 2003B	400,600	—		112,585	—		288,015	8,165
Series 2003C	323,380	—		—	67,380		256,000	—
Series 2003D-O	587,225	—		—	—		587,225	—
Series 2004A	200,000	—		—	—		200,000	—
Series 2006A	—	853,045		13,800	—		839,245	—
Series 2006B	—	96,955		—	—		96,955	—
Series 2006C	—	198,020		—	—		198,020	—
Series 2006D	—	334,710		5,940	—		328,770	590
Series 2006E	—	515,110		7,510	—		507,600	—
Series 2006F	—	518,090		—	—		518,090	3,595
Subtotal	5,826,115	2,542,673		229,575	2,157,000		5,982,213	218,605
Electric system subordinate revenue bonds:								
Series 1-3	525,000	—		—	—		525,000	—
Series 7	250,000	—		—	—		250,000	—
Series 8	160,045	26,480	(b)	27,300	54,500		104,725	—
Subtotal	935,045	26,480		27,300	54,500		879,725	—
LIPA Debt:								
NYSERDA notes	155,420	—		—	—		155,420	—
Net unamortized discounts/premiums and deferred amortization	(28,119)	23,423		—	(12,233)	(c	7,537	—
Total bonds and notes, net of unamortized discounts/premiums	$ 6,888,461	2,592,576		256,875	2,199,267		7,024,895	218,605
Other long-term liabilities:								
Deferred credits	$ 68,601	6,848		1,082	—		74,367	—
Claims and damages	26,581	43,301		38,243	—		31,639	—
Capital lease obligation	1,218,868	—		53,248	—		1,165,620	121,380
Total other long-term liabilities	$ 1,314,050	50,149		92,573	—		1,271,626	121,380

(a) Represents accretion of capital appreciation bonds
(b) Remarketed
(c) Represents normal amortization plus write-off of unamortized discount/premiums on refunded series.

The Company's schedule of capitalization for the years ended December 31, 2007 and 2006 is as follows (thousands of dollars):

	Maturity	Interest rate		Series		December 31 2007	December 31 2006
Electric system general:							
Revenue bonds:							
Serial bonds	Annually to 2011	4.625% to 5.500%	a	1998 A	$	303,045	369,185
Capital appreciation bonds	December 1, 2008 to 2028	4.800% to 5.300%	a	1998 A		140,507	145,923
Serial bonds	Annually to 2011	4.250% to 5.250%	a	1998 B		271,210	382,560
Capital appreciation bonds	June 1, 2010 to 2029	5.360% to 5.950%	a	2000 A		366,057	345,980
Serial bonds	September 1, 2013 to 2014	4.600% to 4.700%	a, d	2001 A		745	745
Term bonds	September 1, 2027 to 2029	5.000% to 5.125%	a, d	2001 A		164,430	164,430
Term bonds	May 1, 2033	3.550%	b	2001 B		75,000	75,000
Term bonds	May 1, 2033	3.600%	b	2001 C		25,000	25,000
Term bonds	May 1, 2033	3.700%	b	2001 D		50,000	50,000
Term bonds	May 1, 2033	3.700%	b	2001 E		50,000	50,000
Term bonds	May 1, 2033	3.800%	b	2001 F		50,000	50,000
Term bonds	May 1, 2033	4.050%	b	2001 G		50,000	50,000
Term bonds	May 1, 2033	5.000%	b	2001 H		50,000	50,000
Term bonds	May 1, 2033	4.150%	b	2001 I		50,000	50,000
Term bonds	May 1, 2033	4.000%	b	2001 J		50,000	50,000
Term bonds	May 1, 2033	4.000%	b	2001 K		50,000	50,000
Term bonds	May 1, 2033	3.450%	b	2001 M		50,000	50,000
Term bonds	May 1, 2033	4.000%	b	2001 N		50,000	50,000
Term bonds	May 1, 2033	3.500%	b	2001 O		50,000	50,000
Term bonds	May 1, 2033	4.000%	b	2001 P		50,000	50,000
Serial bonds	June 1, 2008 to 2009	5.000%	a	2003 A		37,675	53,470
Serial bonds	December 1, 2008 to 2014	3.30% to 5.25%	a, d	2003 B		279,850	288,015
Serial bonds	September 1, 2013 to 2028	4.25% to 5.00%	a, d	2003 C		70,480	70,480
Term bonds	September 1, 2027 to 2033	5.00% to 5.25%	a, d	2003 C		185,520	185,520
Term bonds	December 1, 2029	3.34% to 3.40%	b, d	2003 D-H		293,625	293,625
Term bonds	December 1, 2029	3.00% to 4.50%	b, d	2003 I-O		293,600	293,600
Serial bonds	September 1, 2013 to 2025	3.80% to 4.875%	a, d	2004 A		33,900	33,900
Term bonds	September 1, 2029 to 2034	5.00% to 5.10%	a	2004 A		166,100	166,100
Serial bonds	December 1, 2016 to 2026	4.00% to 5.25%	a, d	2006A		839,245	839,245
Serial bonds	December 1, 2035	4.500%	a	2006B		4,240	4,240
Term bonds	December 1, 2035	5.000%	a	2006B		92,715	92,715
Term bonds	September 1, 2035	5.000%	a	2006C		198,020	198,020
Serial bonds	September 1, 2008 to 2025	4.00% to 5.00%	a, d	2006D		328,180	328,770
Serial bonds	December 1, 2017 to 2022	4.00% to 5.00%	a, d	2006E		507,600	507,600
Serial bonds	May 1, 2011 to 2028	4.00% to 5.00%	a	2006F		401,915	405,510
Term bonds	May 1, 2033	4.250%	a	2006F		112,580	112,580

	Maturity	Interest rate		Series	December 31 2007	December 31 2006
Electric system subordinated						
Revenue bonds	May 1, 2033	3.34% to 3.40%	b	Series 1A-3A	$ 275,000	275,000
	May 1, 2033	3.45% to 3.73%	b, d	Series 1B-3B	250,000	250,000
	April 1, 2025	4.210%	a, d	Series 7	250,000	250,000
	April 1, 2009 to 2011	4.00% to 5.25%	a	Series 8	104,725	104,725
Total general and subordinated revenue bonds					6,670,964	6,861,938
Commercial paper notes		2.80% to 3.23%	c	CP-1	100,000	100,000
NYSERDA Financing notes:						
Pollution control revenue bonds	March 1, 2016	5.150%	a	1985 A,B	108,020	108,020
Electric facilities revenue bonds	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					155,420	155,420
Unamortized premium and deferred amortization					2,899	7,537
Total long-term debt					6,929,283	7,124,895
Less current maturities and short-term debt					526,570	318,605
Long-term debt					6,402,713	6,806,290
Net assets					262,836	169,790
Total capitalization					$ 6,665,549	6,976,080

a – Fixed rate
b – Variable rate issued in 1998, (rate presented is as of December 31, 2007); Auction rate mode reset at rates as determined in accordance with auction procedures
c – Variable rate issued in 1998, (rate presented is as of December 31, 2007).

The debt service requirements for the Company's bonds as of December 31, 2007 are as follows (thousands of dollars):

		December 31, 2007			
Due		**Principal**	**Interest**	**Net swap payments**	**Total**
2008	$	226,570	293,865	7,097	527,532
2009		241,370	293,863	2,911	538,144
2010		224,960	283,152	2,911	511,023
2011		238,100	272,718	2,911	513,729
2012		278,025	262,613	2,911	543,549
2013-2017		1,042,415	1,189,750	14,554	2,246,719
2018-2022		1,100,315	985,368	15,372	2,101,055
2023-2027		1,430,185	747,081	17,737	2,195,003
2028-2032		1,765,330	434,760	3,770	2,203,860
2033-2036		724,080	52,818	—	776,898
		7,271,350	4,815,988	70,174	12,157,512
Unamortized discounts/premiums		2,899	—	—	2,899
Unaccreted interest on CABs		(444,966)	—	—	(444,966)
Total	$	6,829,283	4,815,988	70,174	11,715,445

Future debt service on the variable rate bonds and all future swap payments use an assumed rate of 4.00% for 2008 and 4.50% thereafter. For bonds subject to floating to fixed rate swap agreements, the "net swap payments" represent the fixed swap rate payment net of the assumed future variable rate swap receipts for each agreement. For bonds subject to fixed to floating rate swap agreements, the net swap payments represents the assumed future variable rate swap payments net of the fixed swap rate receipts.

Electric System General Revenue Bonds

Series 2006

In March 2006, the Authority issued Series 2006A and 2006B Electric System General Revenue Bonds. The 2006A Bonds, totaling approximately $853 million par value were used to refund approximately $844 million par value of Series 1998A bonds. This refunding produced approximately $49 million net present value savings. The 2006A bonds have an average life of 16.5 years and an all-in cost of 4.6%. The proceeds from the Series 2006B Bonds, totaling approximately $97 million was used to reimburse LIPA's treasury for capital expenditures for system improvements. The 2006B bonds have an average life of 29 years and an all-in cost of 4.8%.

In July 2006, the Authority issued Series 2006C and 2006D Electric System General Revenue Bonds. The Series 2006C Bonds, totaling approximately $198 million par value, were used to reimburse LIPA's treasury for capital expenditures for system improvements. The Series 2006C Bonds have an average life of 29 years and an all-in cost of approximately 4.9%. The Series 2006D Bonds, totaling approximately $335 million par value, was used to refund approximately $328 million of existing Authority debt including portions of Series 1998A, Series 1998B, Series 2001A and Series 2003C Bonds. The refunding will produce debt service savings of approximately $11.6 million on a net present value basis. The average life of the Series 2006D Bonds is approximately 11 years with an all-in cost of approximately 4.5%.

The Authority also entered into a floating-to-fixed rate swap agreement on a portion of its Series 2006D Bonds for a notional amount of approximately $111 million. This agreement effectively converts the underlying debt obligation from floating rate to a fixed rate of 4.11%. This agreement became effective July 26, 2006 and is co-terminous with the underlying debt maturity of September 1, 2015.

In September 2006, the Authority issued Series 2006E Electric System General Revenue Bonds, totaling approximately $515 million par value to refund approximately $526 million par value of certain Series 1998A bonds. This refunding produced approximately $26 million net present value savings. The 2006E bonds have an average life of 13.7 years and an all-in cost of 4.4%.

In December 2006, the Authority issued Series 2006F Electric System General Revenue Bonds, totaling approximately $518 million par value to refund approximately $514 million of existing Authority debt including portions of Series 1998B, 2001A, 2003C, Series 8 Bonds and all of Series 2001L Bonds. This refunding produced an approximate $29 million net present value savings. The 2006F bonds have an average life of 12.3 years and an all-in cost of 4.2%.

During the fiscal year ended December 31, 2006, the Authority refunded $2.212 billion in existing fixed rate bonds by issuing refunding bonds in a par amount of $2.221 billion at a $111.25 million premium. The result will produce an estimated gross savings of $175.54 million with a present value savings of $115.19 million. The deferred loss on the refunding was $94 million which will be amortized into interest expense in future years. The Authority's refunding activity for 2006 is comprised of the following (thousands of dollars):

Issue description		Refunding par amount	Refunded par amount	Cash flow gain	Present value gain
Series 2006A	$	853,045	843,785	73,794	49,362
Series 2006D		334,710	328,280	17,886	11,595
Series 2006E		515,110	525,610	38,441	25,644
Series 2006F		518,090	513,825	45,420	28,586
	$	2,220,955	2,211,500	175,541	115,187

Commercial Paper Notes

The Authority's Supplemental Bond Resolution authorizes the issuance of Commercial Paper Notes, Series CP-l through CP-3 (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. In connection with the issuance of the Notes, the Authority has entered into a Letter of Credit and Reimbursement Agreement which was renegotiated in 2006. Under the terms of the renegotiated Letter of Credit and Reimbursement Agreement, $250 million expires June 15, 2011 and the remaining $50 million expires on December 15, 2015, subject to right of early termination by the bank on June 15, 2012. 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.

The Company's short-term indebtedness as of December 31, 2007 and 2006 is comprised of the following obligations (thousands of dollars):

	2007			
	Beginning balance	Issuances	Retirements	Ending balance
Short term debt – CP-1	$ 100,000	—	—	100,000
	$ 100,000	—	—	100,000

	2006			
	Beginning balance	Issuances	Retirements	Ending balance
Short term debt – CP-1	$ 100,000	—	—	100,000
	$ 100,000	—	—	100,000

Fair Values of Long-Term Debt

The fair values of the Company's long-term debt as of December 31, 2007 and 2006 were as follows (thousands of dollars):

Fair value

		December 31 2007	December 31 2006
Electric System General Revenue Bonds, Series 1998 A	$	473,737	552,279
Electric System General Revenue Bonds, Series 1998 B		273,963	388,444
Electric System General Revenue Bonds, Series 2000 A		427,283	422,230
Electric System General Revenue Bonds, Series 2001 A		169,956	172,213
Electric System General Revenue Bonds, Series 2001 B through K		500,000	500,000
Electric System General Revenue Bonds, Series 2001 M through P		200,000	200,000
Electric System General Revenue Bonds, Series 2003 A		38,310	54,487
Electric System General Revenue Bonds, Series 2003 B		301,698	308,573
Electric System General Revenue Bonds, Series 2003 C		266,370	273,221
Electric System General Revenue Bonds, Series 2003 D through O		587,225	587,225
Electric System General Revenue Bonds, Series 2004 A		206,955	209,838
Electric System General Revenue Bonds, Series 2006 A		886,926	890,858
Electric System General Revenue Bonds, Series 2006 B		99,320	102,103
Electric System General Revenue Bonds, Series 2006 C		203,616	209,517
Electric System General Revenue Bonds, Series 2006 D		233,300	233,254
Electric System General Revenue Bonds, Series 2006 E		548,311	548,074
Electric System General Revenue Bonds, Series 2006 F		540,567	537,165
Electric System Subordinated Revenue Bonds, Series 1-3 and 1-6		525,000	525,000
Electric System Subordinated Revenue Bonds, Series 7		250,000	250,000
Electric System Subordinated Revenue Bonds, Series 8 (subseries A-C and F)		107,972	108,066
NYSERDA Notes		155,795	157,942
Total	$	6,996,304	7,230,489

(10) 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 Legislature. 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% 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% 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 $892,000, $1.1 million, and $1.3 million, for the years ended December 31, 2007, 2006, and 2005, 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 benefits for Authority employees are not separately computed. 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, 110 State Street, Albany, New York 12244.

(11) Postemployment Healthcare Plan

Plan Description

The Authority is a participating employer in the New York State Health Insurance Program (NYSHIP) which is administered by the State of New York as an agent multiple employer defined benefit plan. Under the plan the Authority provides certain health care for eligible retired employees and their dependents under a single employer noncontributory health care plan. Article XI of the New York State Civil Service Law assigns the authority to NYSHIP to establish and amend the benefit provisions of the plans and to establish maximum obligations of the plan members to contribute to the plan. The Authority's Board is authorized to establish the contribution rates of Authority employees and retirees below those set by Civil Service Law. The NYSHIP program, which the Authority is a participating employer, states that employees and/or their dependents become eligible for these benefits at 55 years of age when the employee has five (5) years of State service. In calculating the five (5) year service requirement, all of the employee's service need not be with the Authority, but may be a composite of New York State service elsewhere, with a minimum of one (1) year with the Authority. Employees with no prior State service must work a minimum of five (5) years before they and their dependents are eligible for the retirement medical benefits. Eligible retirees contribute 10% of the cost of single coverage and 25% the cost of dependent coverage for health insurance benefits. Approximately, 94 participants including 81 current employees, and 13 retired and/or spouses of retired employees were eligible to receive these benefits at December 31, 2007. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State of New York.

Effective January 1, 2007, the Authority prospectively implemented accrual accounting for its OPEB obligations, based on the approach provided in GASB Statement No. 45, *Accounting and Financial Reporting for Post Employment Benefits Other Than Pensions*, issued in June 2004. Prior to adoption, OPEB provisions were recorded on a pay-as-you-go basis. The first actuarial valuation date is January 1, 2007, and the OPEB liability at transition was zero. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Examples include assumptions about employment mortality and the healthcare cost trend. Amounts determined regarding the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The Authority's annual OPEB cost for the plan is calculated based on the Annual Required Contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. GASB 45 does not require that an employer actually contribute its ARC, but allows for the Authority to continue financing these benefits on a pay-as-you-go basis. Since the Authority amortized the entire prior service cost in 2007, the ARC in future periods represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year, actuarial assumptions and plan changes, and interest on the unfunded actuarial liability. Amounts "required" but not actually set aside to pay for these benefits are accumulated as part of the Net OPEB Obligation, and as the Authority has not actually funded the "required" amount, future valuations may produce larger ARCs. The Authority's current period ARC is approximately $12.1 million as detailed in the chart below.

Funding

The contribution requirements (funding) of the Authority's Net OPEB obligation are at the discretion of management and the Board of Trustees. The Authority's Net OPEB obligation continues to be paid on a pay-as-you-go basis. The Authority has not funded a qualified trust or its equivalent.

Actuarial Methods and Assumption

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-tern perspective of the calculations. In the 2007 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 10% (net of administrative expenses) including inflation, declining 1% each year to an ultimate trend rate of 5%. Both rates include a 3% inflation assumption.

OPEB Status and Funding Progress

The Authority's OPEB obligation and the funded status of the plan as of December 31, 2007 is as follows:

Actuarial Accrued Liability (AAL)

		2007
Net OPEB Obligation beginning of year	$	—
Annual required contribution:		
Normal cost	$	1,160,809
Amortization of Unfunded AAL		10,442,310
Interest to year end		522,140
Payments for retirees during year		(64,630)
Net OPEB Obligation end of year	$	12,060,629
Actuarial Accrued Liability (AAL) January 1, 2007	$	10,442,310
Funded OPEB Plan Assets at December 31, 2007		—
Unfunded actuarial accrued liability (UAAL) December 31, 2007	$	10,442,310
Funded ratio (actuarial value of plan assets/AAL)		—%
Covered payroll	$	9,859,403
UAAL as percentage of covered payroll		106%

(12) Commitments and Contingencies

(a) Power Supply Agreement (PSA)

The PSA provides for the sales to LIPA by KeySpan of all of the capacity, energy and, ancillary service output from the oil and gas-fire generating plants on Long Island formerly owned by LILCO. Such sales of capacity and energy are made at cost-based wholesale rates regulated by the Federal Energy Regulatory Commission (FERC). The rates may be modified in accordance with the terms of the PSA for: i) agreed upon labor and expense indices applied to the base year; ii) a return of and return on net capital additions, which require approval by the Authority; and iii) reasonably incurred expenses that are outside of the control of KeySpan. The PSA rates were reset in 2004, and, in accordance with the agreement, will be reset again in 2009. Between 2004 and 2009, the rates will be adjusted annually in accordance with the formula established in the PSA. The annual capacity charge in 2007 and 2006, was approximately $346 million and $334 million, respectively, and the variable charge remained unchanged at $0.90/Mwh.

The PSA provides incentives and penalties for up to $4 million annually, to maintain the output capability of the facilities, as measured by annual industry-standard tests of operating capability, and to maintain/or make capital improvements which benefit plant availability. The performance incentives averaged approximately $4 million in 2007 and 2006.

(b) Purchased Power and Transmission Agreements Assumed from LILCO

As a result of the merger with LILCO, LIPA became party to contracts with numerous Independent Power Producers (IPPs) and the New York Power Authority (NYPA) for electric generating capacity. Certain of these agreements have been renegotiated by LIPA or modified to comply with market rules instituted by the NYISO.

Under the terms of the 2004 amended agreement with NYPA, which will expire in April 2020, 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 nonenergy payments associated with operating and maintaining the plant.

LIPA also has 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 (NYISO) 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 NYISO. 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 NYISO. Under the rules of the NYISO, 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 NYISO.

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 and purchased power costs.

With respect to contracts entered into with the IPPs, LIPA is obligated to purchase all the energy they make available to LIPA. However, LIPA has no obligation to the IPPs if they fail to deliver energy.

As provided by LIPA's tariff, the costs of all of the facilities noted above except for those subject to the PSA will be includable in the calculation of Fuel and Purchased Power Cost. As such, these costs will be recoverable through the FPPCA.

The following table represents LIPA's commitments under the purchased power and transmission contracts assumed from LILCO, as renegotiated or modified (thousands of dollars):

		PPA	Firm transmission	IPPs*	Total business*
For the years ended:					
2008	$	34,412	26,222	153,700	214,334
2009		34,894	23,452	133,800	192,146
2010		35,364	23,461	75,900	134,725
2011		35,850	23,551	68,200	127,601
2012		32,004	24,483	62,900	119,387
2013 through 2017		168,640	120,078	155,500	444,218
2018 through 2022		92,471	91,870	—	184,341
2023 through 2027		—	25,799	—	25,799
2028 through 2032		—	27,498	—	27,498
2033 through 2036		—	11,115	—	11,115
Total	$	433,635	397,529	650,000	1,481,164

* Assumes full performance by NYPA and the IPPs.

(c) *Additional Power Supplies Agreements*

The Company has entered into Power Purchase Agreements (PPAs) with several private companies to develop and operate 17 generating units at sites throughout Long Island. All of the PPAs but one provide for 100% of the capacity, totaling approximately 735 MWs (and associate energy as needed), for the term of each contract, which vary in duration from three to 25 years from contract initiation date. The remaining contract provides the Company with capacity and/or energy of up to 10MW, and is for a term of 30 years.

In accordance with the provisions of FASB Emerging Issues Task Force Issue No. 01-8, *Determining Whether an Arrangements is a Lease* and SFAS No. 13, *Accounting for Leases*, 14 of the generating units, have been accounted for as capitalized lease obligations, whereas the remaining units, are accounted for as operating leases.

In 2000, the Company negotiated an agreement for an undersea high voltage cable running between Connecticut and Long Island whereby LIPA would be entitled to up to 330 megawatts of transmission capacity. The cable owner had not been able to obtain an operating license, as it had been determined that several sections of the cable were not buried to depths required by its permits. As the cable owner has not been able to obtain an operating license, the Authority was under no obligation to remit payments to the owner based on the 2000 lease agreement. However, LIPA and the cable owner have negotiated the terms of a Bridge Agreement, which allows LIPA to utilize the cable through July 1, 2008. Under the Bridge Agreement, LIPA may purchase 330 MW of firm transmission capacity at a discount from the rate contained in the original agreement while the owner of the cable attempted to obtain its operating license. LIPA also entered into an amendment to the original agreement with the cable owner extending the original term of the agreement from 20 to

25 years, at the same rate set in the original agreement, to become effective upon expiration of the Bridge Agreement if the cable owner has obtained its operating license.

During 2006, the Authority completed negotiations to purchase up to 345 MW of additional capacity and varying amounts of energy from a portfolio of facilities located in New England. Service under the agreement commenced in April 2007. The power from this agreement will be transmitted to Long Island over the undersea high voltage cable running between Long Island and Connecticut, discussed above.

In 2005, LIPA entered into an agreement to purchase 660 MW of transmission capacity on an undersea high voltage cable between New Jersey and New York. The cable was completed in 2007 thus permitting LIPA to import 660MW of power and energy from the Pennsylvania, New Jersey and Maryland markets (PJM-ISO). The Authority has entered into an agreement with the owners of a facility located in PJM to secure a long term power capacity supply contract. This agreement will commence on June 1, 2010.

LIPA also entered into an agreement to acquire 286 MW from a 326 MW plant which is being constructed on Long Island and is expected to be in operation no later than 2009.

The following table represents LIPA's minimum payments under its capacity and/or energy contracts (thousands of dollars):

Additional Power Supply Agreements

		Capitalized leases	Other
Minimum lease/rental payments:			
2008	$	202,336	33,152
2009		201,902	23,493
2010		201,784	23,716
2011		202,006	23,941
2012		202,941	24,168
2013 through 2017		1,015,837	126,158
2018 through 2022		750,958	132,227
2023 through 2027		552,006	138,616
2028 through 2032		—	119,981
Total		3,329,770	645,452
Less imputed interest		1,108,773	—
Net present value	$	2,220,997	645,452

(d) Office Lease

The Authority entered into an office lease agreement through January 31, 2011. The future minimum payments under the lease are as follows (thousands of dollars):

Year ended December 31:		
2008	$	1,440
2009		1,494
2010		1,550
2011		129
Total	$	4,613

Rental expense for the office lease amounted to approximately $1.6 million and $1.5 million, respectively, for the years ended December 31, 2007 and 2006.

(e) Insurance Programs

The Authority's insurance program is comprised of a combination of policies from major insurance companies, self-insurance and contractual transfer of liability, including naming the Authority as an additional insured and indemnification.

The Authority has purchased insurance from the New York State Insurance Fund to provide against claims arising from workers' compensation. Liability related to construction projects and similar risks is transferred through contractual indemnification and compliance with Authority insurance requirements. The Authority also has various insurance coverages on its interest in Nine Mile Point Nuclear Power Station, Unit 2 as disclosed in detail in footnote 7.

The Authority is self insured for property damage to its transmission and distribution system and up to $3 million for general liability, including automobile liability. The Authority purchased commercially available excess general liability insurance for claims above the $3 million self insurance provision.

(13) Legal Proceedings

Authority to Set Rates

In February and March 2006, four class action lawsuits were filed in Supreme Court, Nassau County, alleging that LIPA's imposition of fuel and purchased power surcharges on its customers' bills was improper, since LIPA did not obtain Public Service Commission approval prior to the imposition of the surcharges. The lawsuits sought hundreds of millions of dollars in damages as well as an injunction against the continued imposition of the charges. These lawsuits were consolidated into one putative class action and LIPA filed a motion to dismiss on May 17, 2006. The Supreme Court granted LIPA's motion and dismissed the action on September 27, 2006. A notice of appeal was filed on November 1, 2006. On May 1, 2007, plaintiffs perfected their appeal with the Appellate Division, Second Department, and on June 1, 2007, LIPA filed its response. The appeal was orally argued on January 3, 2008. In a unanimous Decision and Order, the Appellate Division affirmed the trial court's dismissal of the action. The Appellate Division determined that the lawsuit was barred by the statute of limitations.

On May 3, 2006, the Authority voluntarily filed two petitions seeking PSC review of LIPA's FPPCA surcharge including the appropriateness of its charges to customers and seeking a confirmation that LIPA is treating fuel and purchased power costs properly and similar to other New York electric companies. The first petition sought a declaratory ruling regarding the PSC's interpretation of its rule on escalation clauses, that the PSC allows utilities to automatically recover increased fuel and purchased power and other costs through escalation clauses. The second petition asked the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, the PSC issued an Order on June 20, 2006, declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. The PSC noted that LIPA is not subject to PSC jurisdiction except in very limited circumstances unrelated to ratemaking, and LIPA's rates, services and practices are not governed by, and need not comply with, the provisions of the Public Service Law and the PSC's regulations. A Petition for Rehearing of the PSC's Order was filed on July 19, 2006. On November 13, 2006, the PSC issued an Order Denying Petition for Rehearing. The PSC stated in the Order that the relief sought by the Petition for Rehearing – full review of LIPA's rates and practices, is not within the PSC's jurisdiction, and authority to grant that relief has not been granted to the PSC by the legislature.

Suffolk County initiated a lawsuit challenging the order of the PSC issued on June 20, 2006 in which the PSC declined to review the reasonableness of LIPA's recovery of fuel and purchased power costs through the FPPCA.

In March 2007, an Article 78 proceeding was filed against LIPA, the PSC and certain PSC officials, in Supreme Court, Albany County, seeking to, among other things, annul the PSC's determination that it lacked jurisdiction to review LIPA's fuel and purchased power surcharge, and compel the PSC to conduct an evidentiary hearing regarding such surcharge. By Decision and Judgment dated September 14, 2007, Supreme Court, Albany County, the proceeding was dismissed on the merits. The Court found that the plain language of the LIPA Act precludes the PSC's review of LIPA's rates, services and practices.

By letter dated June 18, 2007, the Authority requested the PSC to engage in a voluntary review process of certain increases in the Authority's base rates and FPPCA surcharge, and to establish certain conditions relating to such a review. By response dated June 27, 2007, the PSC indicated that it had no statutory or other legal right to engage in any such review and/or to issue an advisory opinion to the Authority on such rate matters.

Environmental

In connection with the LIPA/LILCO Merger (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).

National Grid 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 nonnuclear 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 other than those related to MGP sites 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

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 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. 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 litigation against owners and operators was tried in the fall of 2002, which resulted in a finding of liability against Metal Bank in January 2003. In May, 2003, the Metal Bank parties filed for Federal Bankruptcy protection under Chapter 11, resulting in a reorganization plan that obligated the emerging entity to fund $13.25 million of the final remedy with no further obligation. After mediation, a final global settlement was negotiated, which did not require any monetary payment from the PRPs, but required the collective payment of $9.6 million from two of the owners. In 2005, Final Consent Decrees were published for public comment, the public hearing was held, and the Federal Judge approved the Decrees, making all the settlement terms final, and formally ending the litigation. The Utilities Group (of which LIPA is a party) submitted a Revised

Remedial Design Plan and a Revised Remedial Work Plan to the EPA. After approval of the plans, the field remediation work will begin.

As a result of the entry of the Consent Decrees, the Utilities Group were paid approximately $4 million by the defendant owners, which the Utilities Group currently holds in investment accounts and payments toward the $13.25 million remediation funds have commenced by the Union Trust, as the successor in bankruptcy to Metal Bank.

During the summer of 2007, the EPA raised a number of questions regarding the design and remedial work plans. The Utilities Group desired to initiate construction work prior to the end of 2007 and revised plans were submitted in November 2007, which are still under review by EPA. In January of 2008, EPA provided a draft agreement providing for transfer of the balance of the Union Trust's funds to EPA-controlled accounts. This was prompted by a request from the Union Trusts' parent to EPA to make use of the funds for other projects. EPA and the Utilities Group agree that the funds should be moved to ensure that they are available for the project. The Utilities Group examined the agreement for consistency with the Group's consent decree with EPA and the bankruptcy settlement documents.

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, 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. This remedial work has been completed. The site is in the process of being formally closed out by the EPA.

Environmental Matters Which may be Recoverable from LIPA by KeySpan Through the PSA

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. In a related matter, certain individual residents of the Village commenced an action in New York Supreme Court Suffolk County seeking similar relief (Sbarro v. Long Island Lighting Company). The cases were tried jointly before a judge without a jury. The trial was completed in December 2002 and the parties filed post-trial briefs in March 2003. Since that time, the judge passed away and the case has been reassigned. The new judge dismissed the case after reviewing the existing and supplemental record. The Village has filed a notice of appeal of this decision and, recently, has obtained an extension of time to perfect their appeal. 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.

Asbestos Proceedings

Litigation is pending in State Court against LIPA, LILCO, KeySpan and various other defendants, involving thousands of plaintiffs seeking damages for personal injuries or wrongful death allegedly caused by exposure to asbestos. The cases for which LIPA may have financial responsibility involve employees of various contractors and subcontractors engaged in the construction or renovation of one or more of LILCO's six major power plants. These cases include extraordinarily large damage claims, which have historically proven to be excessive. The actual aggregate amount paid to plaintiffs alleging exposure to asbestos at LILCO power plants over the years has not been material to LIPA. Due to the nature of how these cases are litigated, it is difficult to determine how many of the remaining cases that have been filed (or of those that will be filed in the future) involve plaintiffs who were exposed to asbestos at any of the LILCO power plants. Based upon experience, it is likely that LIPA will have financial responsibility in a significantly smaller percentage of cases than are currently pending (or which will be filed in the future) involving plaintiffs who allege exposure to asbestos at any of the LILCO power plants.

Future Environmental Compliance Obligations

LIPA, through its contractual obligations to KeySpan under the PSA and the MSA, and other Independent Power Producers and transmission cable operators, under various power purchase agreements (PPAs), may be subject to the cost of compliance with various current and potential future environmental regulations as promulgated by the federal government and by state and local governments with respect to environmental matters, such as emission of air pollutants, cooling water for generation, the handling and disposal of toxic substances and hazardous and solid wastes, the handling and use of chemical products, and the handling and storage of fossil fuels. Electric utility companies generally use or generate a range of pollutants, potentially hazardous products and by-products that are the focus of such regulation. LIPA is also subject to state laws regarding environmental approval and certification of proposed major transmission facilities.

From time to time environmental laws, regulations and compliance programs may require changes in the operations and facilities that supply power to LIPA, and may increase the cost of energy delivery service. Certain of these costs may be reduced in the future, dependent on a capacity ramp down right that is available to LIPA beginning in 2008 under the PSA, the same time period where several compliance obligations occur. Historically, rate recovery has been authorized for environmental compliance costs.

The Clean Air Act Amendments of 1990 (1990 Amendments) limit emissions of sulfur dioxide (SO2), nitrogen oxides (NOx) and other pollutants. The U.S. Environmental Protection Agency (EPA) allocates annual sulfur dioxide emissions allowances to each of the PSA units based on historical output. NOx emissions are regulated on a regional level through the Ozone Transport Commission, and are also controlled through allowance allocations. Generating units under the various PPAs and the PSA units are expected to continue to achieve cost effective compliance with these emission control requirements through capital expenditures, the use of natural gas fuel, and/or the purchase of emission allowances when necessary. LIPA may be required to purchase additional allowances above the PSA unit allocations based on changes in fuel prices.

In 2003 the State of New York promulgated separate regulations that would further limit SO2 and NOx beginning in 2004. The PSA units have been complying with the NOx requirements without additional material expenditures, and lower sulfur fuel (0.7% S) has been used at Northport and Port Jefferson to meet the SO2 regulations. No additional reduction in fuel sulfur is expected to be needed to comply with this regulation.

In 2005, seven Northeast states signed a Memorandum of Understanding called the Regional Greenhouse Gas Initiative (RGGI) for the purpose of capping and then reducing greenhouse gas emissions from power plants. At this time 10 Northeast states have signed on. Several similar initiatives are also being considered at the federal level. New York State has issued a draft regulation to implement the requirements of RGGI and is planning on auctioning all of the CO2 allowances comprising the New York share of the regional cap (other states are contemplating auctioning of allowances as well). The cost of the allowances is unknown; however current information indicates that initially the price may be in the range of $2-$9/ton. The ability of the major PSA units to burn lower CO2 emitting natural gas provides compliance flexibility for these units. Forecast CO2 emissions are on the order of 6 million tons of CO2 annually.

In March 2005, the Federal Clean Air Interstate Rule (CAIR) was promulgated, requiring further reduction of SO2 and NOx emissions. Depending on the outcome of one or more legal challenges, compliance requirements for NOx reduction would begin in 2009. As part of the National Grid/LIPA Agreement, National Grid, subject to the terms of the agreement, plans on installing additional NOx controls on all the units at Northport and Port Jefferson, to help further reduce NOX emissions. The CAIR rules will require the surrender of two SO2 allowances for each ton of SO2 emissions beginning in 2010 and 2.86 allowances per ton of emission in 2015 and beyond. Further SO2 reductions, if needed for CAIR compliance, could be achieved through the use of lower sulfur fuels (lower percent sulfur oil, natural gas) or the purchase and use of additional emission allowances beyond the current allocation as necessary.

Another rule issued in March of 2005, the Clean Air Mercury Rule (CAMR) set new limits for mercury emissions from coal-fueled plants. These do not apply to the PSA units. The rule making process considered, but ultimately determined not to regulate nickel emissions from oil fired units which would have affected some PSA units and units under PPAs that burn oil. Some aspects of CAMR are being litigated. Accordingly, it can not be determined whether EPA's decision not to regulate nickel will be sustained or whether any future compliance obligations will be imposed. These regulations could impact the pricing of purchased power.

In 2007, member states of the Ozone Transport Commission determined that additional NOx emission reductions would be required from electric generating facilities during High Electric Demand Days (HEDD). Though New York State has not yet proposed regulations to implement these requirements, it is anticipated that additional NOx controls will be required on some or all of the simple cycle combustion turbines. Installation of water injection at the Holtsville combustion turbines is being planned for the 2009-2010 time frame, with an estimated cost of approximately $8M.

(Continued)

KeySpan and the DEC are parties to a 1998 Consent Order for opacity, for which certain fines are assessed for exceeding the opacity limits. Improvements in plant infrastructure and plant operating practices have significantly reduced the amount of fines in recent years.

The Clean Water Act (CWA) requires that electric generating stations hold State Pollutant Discharge Elimination System (SPDES) permits, which reflect water quality considerations for the protection of the environment. Additional capital expenditures will be required by the New York State Department of Environmental Conservation (DEC) to protect marine life from possible impacts from the steam electric generators' cooling water intake systems. KeySpan has undertaken the study of the impact of current permit conditions on aquatic resources in consultation with the DEC and has determined in most cases that reducing cooling water flow during certain periods should be sufficient to meet the performance standards established by the DEC. The nature and extent of any expenditure cannot be finalized until ongoing analysis of the impacts and mitigation discussions with NYSDEC are completed. At this time, estimates for compliance upgrades are expected to cost up to $60 million.

(14) Subsequent Events

In March 2008, the Authority redeemed $200 million of its insured variable rate Electric System General Revenue Bonds to lower the risks associated with their marketability. The Authority used cash on hand to redeem these securities.

Also in 2008, the Authority may issue up to $975 million aggregate principal amount of Electric System Revenue Bonds for the purposes of (i) refunding certain outstanding bonds and lowering the risks associated with the marketability of certain insured bonds, (ii) funding the cost of system improvements and (iii) costs of issuance. The Authority will also amend its resolution to the Authority's outstanding variable rate bonds for the purpose of adding additional interest rate modes including weekly and daily rate mode and amending the terms of existing interest rate modes for such bonds. Further, the Authority's Board has provided its approval to enter into interest rate swap agreements in an aggregate notional amount of up to $975 million.

KPMG LLP
Suite 200
1305 Walt Whitman Road
Melville, NY 11747-4302

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Long Island Power Authority:

We have audited the basic financial statements of the Long Island Power Authority (Authority) as of and for the year ended December 31, 2007, and have issued our report thereon dated March 17, 2008. We conducted our audit 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Authority's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Authority's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of Authority management, the Authority's Board of Trustees, the New York State Division of the Budget and the New York State Office of the State Comptroller and is not intended to be and should not be used by anyone other than those specified parties.

KPMG LLP

March 17, 2008