

**LONG ISLAND POWER AUTHORITY**

**MINUTES OF THE FINANCE AND AUDIT COMMITTEE MEETING**

**HELD ON MARCH 29, 2017**

*The Finance and Audit Committee of the Long Island Power Authority (the "Authority") was convened at 8:01 a.m. at LIPA Headquarters, Uniondale, NY, pursuant to legal notice given on March 23, 2017 and electronic notice posted on the Authority's website annually.*

*The following Trustees of the Authority were present:*

**Shelly L. Cohen, Committee Chair  
Elkan Abramowitz  
Mark Fischl**

**Representing the Authority were Thomas Falcone, Chief Executive Officer; Joseph Branca, Chief Financial Officer; Jon Mostel, General Counsel; Bobbi O'Connor, Deputy General Counsel; Kenneth Kane, Vice President of Financial Oversight; Donna Mongiardo, Controller; Corey Horowitz, Director of Power Supply Risk Management; and Kathleen Mitterway, Director of Audit.**

**Representing KPMG were Todd Fowler, Mike Percent and John Pontecorvo.**

**Representing PSEG LI were David Lyons, Vice President of Business Services and Markus Ramlall, Director of Finance.**

*Chair Cohen welcomed everyone to the Finance and Audit Committee meeting of the Long Island Power Authority Board of Trustees.*

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*Chair Cohen stated that the first item on the agenda is the adoption of the minutes from the January 25, 2017 Committee meeting.*

*Chair Cohen made a motion to accept the minutes of the January 25, 2017 meeting. Upon motion duly made and seconded, the minutes were approved unanimously.*

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*Chair Cohen stated that next item on the agenda is the Overview of Financial Results & Hedge Report.*

*Ms. Mongiardo presented LIPA's February financial results. Mr. Lyons and Mr. Ramlall of PSEG LI reported on the PSEG LI Operating Results. Mr. Horowitz presented the Hedge Report.*

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*Chair Cohen stated that next item on the agenda is Internal Audit Activities which would be presented by Kathleen Mitterway.*

*Ms. Mitterway gave a presentation regarding the Authority's internal audit activities and then took questions from Trustees.*

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*Chair Cohen stated that the next item on the agenda is the review of Internal Audit Charter and Confirmation of Independence, which would be presented by Kathleen Mitterway.*

*Ms. Mitterway presented the following action item and took questions from the Trustees:*

### **Requested Action**

The Finance and Audit Committee (the "Committee") is being requested to adopt a resolution recommending revisions to the Long Island Power Authority (the "Authority") Internal Audit Charter (the "Charter") in the form attached hereto.

### **Background**

The Charter, which was most recently adopted by the Committee on March 9, 2015, establishes the purpose, authority and responsibilities of Internal Audit. Consistent with the Charter, the Committee has undertaken a thorough review of the Charter's adequacy and recommends some changes including recognition of the mandatory nature of the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing ("Standards") and the Definition of Internal Auditing in the Charter, based on the revised Standards, effective January 2017.

## Recommendation

Based upon the foregoing, I recommend approval of the above-requested action by adoption of a resolution in the form of the draft resolution attached hereto.

*A motion was made and seconded, and the Trustees unanimously adopted the following resolution:*

### **RECOMMENDATION FOR APPROVAL OF REVISED LONG ISLAND POWER AUTHORITY INTERNAL AUDIT CHARTER**

WHEREAS, the Trustees adopted on March 9, 2015, an Internal Audit (“Charter”) which establishes, among other things, the purpose, authority and responsibilities of Internal Audit; and

WHEREAS, the Trustees have reviewed the proposed revised Internal Audit Charter and believes it is reasonable and appropriate to revise it for the reasons set forth in the accompanying memorandum:

NOW, THEREFORE, BE IT RESOLVED, that the Trustees hereby adopt the Long Island Power Authority’s “Internal Audit Charter (March 29, 2017)” in the form presented at this meeting; and be it further

RESOLVED, that this resolution take effect immediately.

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*Chair Cohen stated that the next item on the agenda is the presentation of the 2016 Audit Results, which would be presented by Donna Mongiardo and representatives from KPMG.*

*Ms. Mongiardo gave a brief introductory presentation regarding the financial statements. Mr. Fowler, Mr. Percent and Mr. Pontecorvo then presented the 2016 Audit Results and then took questions from the Trustees.*

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*At approximately 8:25 a.m. Chair Cohen stated that the Committee would adjourn to Executive Session to discuss personnel matters. Chair Cohen stated that no votes would be taken and that the Committee would resume its public session afterward.*

*After noting that no votes were taken in the Executive Session, the public portion of the meeting of the Finance and Audit Committee reconvened at approximately 8:30 a.m.*

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*Chair Cohen stated that the next item on the agenda is consideration of recommendation to approve the 2016 Financial Report, which would be presented by Joseph Branca.*

*Mr. Branca presented the following item and then took questions from the Trustees:*

### **Requested Action**

The Finance and Audit Committee (the “Committee”) of the Board of Trustees (the “Board”) is being requested to recommend approval by the Board of the proposed financial report section of the 2016 annual report of the Long Island Power Authority (the “Authority”), prepared in accordance with Section 2800(1) of the Public Authorities Law (“PAL”), in the form attached hereto as Exhibit B.

### **Background**

Section 2800(1) of the PAL requires the Authority to submit an annual report to the Governor, the Chairman and ranking minority member of the Senate Finance committee, the Chairman and ranking minority member of the Assembly Ways and Means committee, the State Comptroller, and the Authorities Budget Office, within ninety days after the end of the Authority’s fiscal year.

The annual report includes, among other things, the Authority’s financial report for the fiscal year just ended. Under Section 2800(1)(a)(2) of PAL, the financial report shall include the following: audited financials; grant and subsidy programs; operating and financial risks; current bond ratings; and long-term liabilities (the “Financial Report”). Section 2800(3) of PAL requires the Financial Report to be approved by the Board.

### **Recommendation**

Based upon the foregoing, it is recommended that the Committee adopt a resolution in the form of the draft resolution attached hereto as Exhibit A.

*A motion was made and seconded, and the Trustees unanimously adopted the following resolution:*

**RECOMMENDATION OF APPROVAL OF 2016 FINANCIAL REPORT OF THE LONG ISLAND POWER AUTHORITY**

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WHEREAS, Section 2800(1) of the Public Authorities Law (“PAL”) requires public authorities such as the Long Island Power Authority (the “Authority”) to prepare an annual report; and

WHEREAS, the Authority’s annual report includes, among other things, a financial report, as defined under Section 2800(1)(a)(2) of PAL (the “Financial Report”); and

WHEREAS, the Authority has prepared its Financial Report, which, pursuant to Section 2800(3) of PAL, is subject to the approval of the Trustees; and

WHEREAS, the Finance and Audit Committee has thoroughly reviewed the Authority’s Financial Report.

NOW, THEREFORE, BE IT RESOLVED, that the Finance and Audit Committee of the Board of Trustees hereby recommends that the Board approve the 2016 Financial Report of the Long Island Power Authority, in the form presented at this meeting.

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*Chair Cohen stated that the next item on the agenda is consideration of recommendation to approve the Board Policies on Enterprise Risk Management, Power Supply Hedging, Interest Rate Exchange Agreements and Audit Relationships, Revisions to the Board Policies on Prompt Payment, Debt and Access to Credit Markets and Regionally Competitive Rates and the 2016 Investment Report, which would be presented by Joseph Branca, Kathleen Mitterway and Justin Bell.*

*Mr. Branca, Ms. Mitterway and Mr. Bell presented the following item:*

### **Requested Action**

The Finance and Audit Committee (the “Committee”) of the Board of Trustees (the “Board”) of the Long Island Power Authority (the “Authority”) is requested to adopt resolutions recommending that the Board approve (i) Board policies regarding Prompt Payment, Enterprise Risk Management, Power Supply Hedging, Interest Rate Exchange Agreements, Audit Relationships and Economic Development, (ii) revisions to the previously adopted Board Policies regarding Debt and Access to the Credit Markets and Regionally Competitive Rates and (iii) the 2016 Annual Investment Report, each as further described below.

### **Prompt Payment Policy**

Section 2880 of the Public Authorities Law (“PAL”) requires that the Authority adopt a policy for making payment promptly on amounts properly due by the Authority under its contracts. This policy generally applies to payments due by the Authority to a person or business in the private sector under a contract it has entered into with the Authority. Except as otherwise provided by law or regulation or under certain circumstances specified in the policy, the payment due date of an amount properly due by the Authority under a contract is thirty calendar days, excluding public holidays, after receipt of an invoice for such amount due; except that if such thirtieth calendar day falls on a Saturday or Sunday, the payment due date shall be the following business day. The prompt payment policy was last reviewed and approved by the Board on May 18, 2016. The proposed Board Policy on Prompt Payments is intended to replace the prior policy and clarifies that the policy applies to the Authority, as well as Long Island Lighting Company and the Utility Debt Securitization Authority (“UDSA”) to the extent the Authority acts as servicer and administrator to the UDSA.

### **Enterprise Risk Management Policy**

The Board approved a Governing Policy for Enterprise Risk Management (“Previous ERM Policy”) on August 7, 2015 which set forth the development of a comprehensive Enterprise Risk Management (“ERM”) Program designed to provide a repeatable, reliable mechanism by which Authority’s staff and the Authority’s major service provider PSEG Long Island can collectively identify, evaluate, and mitigate risks to the Authority. The ability of the Authority and PSEG Long Island to effectively manage risks is integral to achieving the Authority’s mission, goals, and objectives and is in the best interest of the Authority’s customer-owners.

The recommended policy for Enterprise Risk Management (the “Proposed ERM Policy”) continues the practice by the Authority and PSEG Long Island to identify, assess, manage, and mitigate its financial, operational, supply, physical security, cyber security, legal, legislative, regulatory, reputational and other risks and is consistent with, and required by, best utility practices.

Several of the key provisions of the Proposed ERM Policy include the following:

- Continuously monitoring the risks facing the Authority, and providing regular updates on the status of risks and corresponding mitigation activities to the senior management of the Authority and its Service Provider as well as reporting at least annually to the Committee on such risks and mitigation activities;
- Annually reviewing the Authority’s insurance and other forms of coverage against insurable risks, including the availability and economics of such coverage;
- Maintaining business continuity plans for the operations of the Authority and periodically reviewing such plans of the Service Provider; and
- Requiring the Authority’s Audit staff to annually undertake a review of the effectiveness and maturity of the ERM program.

The Proposed ERM Policy has no material difference from the Previous ERM Policy but has been updated as to form for greater consistency with the other policies adopted by the Board.

### **Power Supply Hedging Policy**

The Board last reviewed the Governing Policy for the Power Supply Hedging Program (“Previous Hedging Policy”) on August 6, 2014. Recently, a thorough review of the Previous Hedging Policy was completed by the Authority’s staff.

The overall objectives of the hedging program identified in the proposed Board Policy for Power Supply Hedging (the “Proposed Hedging Policy”) continue to solidify alignment with the Authority’s mission and the interest of its customer-owners for more stable and predictable power supply prices on a month-to-month basis. The only substantive proposed change from the Previous Hedging Policy to the Proposed Hedging Policy is the change in the maximum net hedge position from 85% to 90% in the Proposed Hedging Policy. Additionally, the format of the policy has been updated to conform to other recent policies adopted by the Board.

The Power Supply Hedging Program’s focus will continue to be:

- Mitigation of the volatility of the Authority’s month-to-month Power Supply Charge
- Use of derivatives and physical fuel and purchased power contracts similar to what
- New York State regulated utilities use to restrain price volatility
- Achievement of appropriate risk mitigation and a prohibition of financial speculation; and
- Transparency regarding the Authority’s commodity risk management activities and the results of such activities

In addition, the Executive Risk Management Committee will establish, maintain and monitor the implementation of the Proposed Hedging Policy.

### **Interest Rate Exchange Agreement Policy**

The Trustees last adopted Guidelines for the Use of Interest Exchange Agreements (“Swap Guidelines”) on May 18, 2016.

The proposed Board Policy for Interest Rate Exchange Agreements (the “Proposed Swap Policy”) recognizes the importance to the Authority to properly manage the risks associated with its debt portfolio. The objective of the interest rate exchange agreement program is to provide the Authority the ability to diversify its debt portfolio, mitigate potential risks and/or lower the cost of borrowings.

The Proposed Swap Policy has been updated as to form to be similar to the other policies approved by the Board but has no material changes relative to the Board-adopted Swap Guidelines currently in effect.

### **Audit Relationships Policy**

The Finance & Audit Committee of the Authority's Board of Trustees, in its charter, was delegated the responsibility of reviewing the Authority's policies regarding Audit Relationships.

This proposed Board Policy on Audit Relationships defines the expectations of the Board regarding the existing authority granted to the Finance & Audit Committee for:

- Selecting an independent certified public accounting firm to conduct annual audits of the Authority.
- The annual review of the audit plan as well as the charter, activities, staffing, budget, and organizational structure of the Internal Audit Department and confirming the independence of the internal auditors.
- Monitoring, in consultation with the Director of Audit, the significant findings of internal audit reports and the status of the implementation of management's action plans in response to such audit findings.

### **Economic Development Policy**

The Committee seeks to provide policy guidance regarding rates and programs that align with State policy to promote the economic growth and vitality of the Authority's service territory through an Economic Development Policy, consistent the expectations of the Authority's enabling statute. The recommended Economic Development Policy continues the practice of the Authority since its inception. Efforts have always been made to attract new businesses, retain existing businesses, and promote economic growth in its service territory through a variety of programs and targeted rates. The Authority has cooperated with and participated in Statewide programs to promote economic development, and promoted its own programs through the Tariff and other activities that have been directly funded through approved budgets.

Presently the Authority's service provider, PSEG Long Island, maintains a team of economic development specialists that develops and markets new economic development programs, manages existing programs, identifies and enrolls eligible customers, and monitors customers' energy usage and compliance with program requirements. This team also coordinates energy efficiency and renewable initiatives to help customers with their energy costs and needs.

Annually, the Authority staff will present an evaluation of the Economic Development Policy to the Board which will review (1) customer and other stakeholder participation in the Authority's Economic Development rates and programs, (2) associated costs and benefits including the number of jobs and businesses supported by the economic development activities of LIPA and its Service Provider, and specifying, to the extent reasonably knowable, the portion of such jobs and new businesses that were newly

attracted to the service territory based on the availability of LIPA's economic development rates and program and (3) consistency and coordination with State and regional efforts and industry best practices.

As part of its review of any annual evaluation, the Board will consider, with the advice of Authority staff and the Service Provider where appropriate, whether any updates or revisions should be made to the respective policy statement.

### **Revisions to Board Policy on Debt and Access to the Credit Markets**

The Board adopted the Debt and Credit Markets Policy on December 15, 2015. The policy adopted by the Board reflected the methodology used by the major public power utilities in the United States by developing financial targets for use in budgeting and rate setting, and to provide a measure of annual financial performance. These financial targets were modeled after the public power credit rating criteria of the three major credit rating agencies, and include targets for the most commonly followed financial performance indicators, including credit ratings, debt/fixed obligation coverage, capitalization, and liquidity targets. The adoption of the new policy in 2015 marked the end of LIPA's historic fiscal practice of budgeting revenues and expenses to achieve net income of \$75 million per year. This historic net income target approach produced results that did not correlate well to the financial metrics followed by the vast majority of public power credit analysts.

The targets were devised in consultation with Public Financial Management ("PFM"), the Authority's financial advisor, who presented a study of the Authority's financial policies to the Finance and Audit Committee in 2014 and filed such a study as part of the Authority's Three-Year Rate Plan in 2015. That study noted that the Authority had the lowest credit ratings and most leveraged balance sheet of any of its peer utilities by a significant degree, and recommended that the Authority adopt financial targets that focused on the lowest electric rates consistent with sound long-term financial operations. Accordingly, the financial policies recommended by PFM were set to be sufficient, in PFM's opinion, for LIPA to obtain mid-single-A bond ratings within five years, which would place the Authority's credit ratings at the low end of the range of the credit ratings of its peer utilities.

In the Three-Year Rate Plan filing on January 30, 2015, the Authority proposed and subsequently adopted the Public Power Model and set fixed obligation coverage targets (debt service plus amortization of capital leases) that increased from 1.20x coverage in 2016 to 1.45x coverage by 2019. The long-term coverage target of 1.45x, combined with certain cost recovery mechanisms, target a reduction in the percentage of capital investments funded by debt to 64% or less over the planning period. In addition, the Authority would maintain a fixed obligation coverage ratio of at least 1.25x on all its debt (including the Utility Debt Securitization Authority).

Fiscal Year 2016 was the first full year in which the Authority budgeted using the revenue requirements set by the Public Power Model. The rating agencies and credit markets reacted favorably to the new approach. In August 2016, LIPA received its first credit ratings upgrade in 11 years from Moody's Investor Service with an upgrade to A3. The Moody's report cited the Three-Year Rate Plan and the adoption of the new financial model. The Authority has met or exceeded its targeted metrics in 2016 and has budgeted to

meet targets in 2017 and continue to move towards the stated objectives in the policy in 2018.

Staff now proposes to modify the Board Policy to include funding the Authority's Other Post-Employment Benefits ("OPEBs") and Nuclear Decommissioning Trust Fund ("NDTF") obligations in a fiscally sound manner by funding on a recommended schedule as calculated no less than every third year by an actuarial services firm. The Three-Year Rate Plan included funding for such obligations, and the Board previously adopted a pre-funding policy for OPEBs in 2014 at the time it created an OPEB Account. However, staff believes a statement of principle included in the board policies that these accounts should continue to be funded in an actuarially sound manner beyond the Three-Year Rate Plan is an important statement to the rating agencies and credit markets.

The Board Policy also includes other non-material clarifications such as the balance of funds to be held in individual accounts and a more explicit statement of the target fixed obligation coverage ratios in each year, in accordance with those adopted in the Three-Year Rate Plan. Finally, staff has added an appendix to the Board Policy that further describes the calculation of each of the financial metrics contained within the Policy.

#### Revisions to Board Policy on Regionally Competitive Rates

In December of 2015, the Committee recommended adoption of the Competitive Rates Policy, which was subsequently adopted by the full Board in September of 2016. The purpose of the Competitive Rates Policy has been to set reasonable objectives for the Authority's electric rates and to evaluate its electric rates and their rate of change over time relative to other similar utilities. The Board conducts an annual review of the policy and, with the advice of Authority staff and the Service Provider where appropriate, considers as part of its annual review whether any updates or revisions should be made to the policy statement.

The Competitive Rates Policy, as originally adopted, identifies four similarly situated regional utilities in the downstate New York and Connecticut region that surround the Authority's service territory and resemble the costs and power/gas supply options of the Authority: Consolidated Edison, Orange & Rockland, United Illuminating, and Eversource (formerly Connecticut Light and Power).

The Competitive Rates Policy also lists several rate design objectives for the Authority to pursue. Specifically, rates should, consistent with prudent utility practice: be simple and easy to understand; equitably allocate costs across and within customer classes, taking into consideration the cost to provide service; and where possible, be consistent with statewide policies. In addition, in order to promote the goals of Reforming the Energy Vision, rates should be designed to encourage the most efficient use of utility plant.

#### Proposed Amendments

The Authority staff now proposes that the Board amend the Competitive Rates Policy to add PSE&G to the list of utilities to which the Authority's rates will be compared and to add an additional rate design objective. It has always been a part of the mission of the Authority to keep rates affordable for all of its customers. This includes customers with low

incomes and customers with severe medical conditions. The Authority also seeks to set policy that, whenever feasible, is consistent with policy espoused by the New York Public Service Commission, which has recently issued a series of orders directing the regulated utilities to strengthen their existing protections for low income customers. In addition, staff proposes that the Board clarify what is meant by the objective of encouraging the most efficient use of utility plant and what is meant by a similarly situated utility.

### **2016 Annual Investment Report**

Section 2925 of the Public Authorities Law requires that the Authority annually review and approve an investment report. The Authority's investments are managed by an investment manager and the investments are primarily short term, highly liquid investments. All investments of Authority funds are governed by the Authority's Investments Guidelines adopted in May 2016 and included as an attachment to the 2016 Investment Report. The Authority's investments for 2016 performed consistent with Staff's expectations given the nature of the investments.

### **Recommendation**

Based upon the foregoing, I recommend approval of the above requested action by adoption of the resolutions in the forms attached hereto as Exhibits A-I.

*A motion was made and seconded, and the Trustees unanimously adopted the*

*following resolutions:*

#### **RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON PROMPT PAYMENT**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Prompt Payment, in the form presented at this meeting to be effective immediately.

#### **RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON ENTERPRISE RISK MANAGEMENT**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Enterprise Risk Management, in the form presented at this meeting to be effective immediately.

#### **RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON POWER SUPPLY HEDGING**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Power Supply Hedging, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON INTEREST RATE EXCHANGE AGREEMENTS**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Interest Rate Exchange Agreements, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON AUDIT RELATIONSHIPS**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Audit Relationships, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF BOARD POLICY ON ECONOMIC DEVELOPMENT**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Board Policy on Economic Development, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF REVISIONS TO THE BOARD POLICY ON DEBT AND ACCESS TO THE CREDIT MARKETS**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts revisions to the Board Policy on Debt and Access to the Capital Markets, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF REVISIONS TO THE BOARD POLICY ON REGIONALLY COMPETITIVE RATES**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts revisions to the Board Policy on Regionally Competitive Rates, in the form presented at this meeting to be effective immediately.

**RECOMMENDATION FOR APPROVAL OF THE ANNUAL INVESTMENT REPORT**

**RESOLVED**, that the Finance and Audit Committee of the LIPA Board of Trustees hereby recommends that the full Board adopts the Annual Investment Report for the period ended December 31, 2016 in the form presented at this meeting to be effective immediately.

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*Chair Cohen stated that the next item on the agenda is discussion of Committee's Annual Report to the Board of Trustees, which would be presented by Jon Mostel.*

*Mr. Mostel discussed the Committee's Annual Report to the Board of Trustees and then took questions from the Trustees.*

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*Chair Cohen then entertained a motion to adjourn, which was duly made and seconded, after which the meeting concluded at approximately 9:10 a.m.*