**MINUTES OF THE REGULAR MEETING
OF THE
AUDIT COMMITTEE**

March 26, 2015

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Minutes of the regular meeting of the New York Power Authority's Audit Committee held via video conference at the following participating locations, at approximately 8:30 a.m.:

New York Power Authority, 123 Main Street, White Plains, NY
New York Power Authority, 95 Perry St., Suite 401, Buffalo, NY

The following Members of the Audit Committee were present:

Trustee Eugene Nicandri, Chairman
Trustee Jonathan Foster
Trustee Terrance Flynn

Also in attendance were:

John Koelmel	Chairman, NYPA
Gill Quiniones	President and Chief Executive Officer
Justin Driscoll	Executive Vice President and General Counsel
Robert Lurie	Executive Vice President and Chief Financial Officer
Jennifer Faulkner	Senior Vice President – Internal Audit
Karen Delince	Vice President and Corporate Secretary
Thomas Concadoro	Vice President and Controller
Joseph Gryzlo	Vice President and Chief Ethics & Compliance Officer
Lorna Johnson	Associate Corporate Secretary
Sheila Baughman	Assistant Corporate Secretary
Peter Prunty	Director – Infrastructure
Greg Jablonsky	Manager – Network Services
Glen Martinez	Senior Network Analyst
Anna Devine	Coordinating Partner – Ernst & Young
Lynne Coviello	Senior Manager, Advisory Services – Ernst & Young
Todd Fowler	Lead Engagement Audit Partner – KPMG
Nicholas DiVirgilio	Lead Engagement Audit Manager – KPMG

Chairman Eugene Nicandri presided over the meeting. Corporate Secretary Delince kept the Minutes.

Introduction

Chairman Nicandri welcomed committee members, Trustees Jonathan Foster and Terrance Flynn, senior staff and outside consultants to the meeting. He said the meeting had been duly noticed as required by the Open Meetings Law and called the meeting to order pursuant to section B(4) of the Audit Committee Charter.

1. Adoption of the Proposed Meeting Agenda

Upon motion made and seconded the agenda for the meeting was adopted, as amended.

2. CONSENT AGENDA

Upon motion made and seconded the Consent Agenda was approved.

a. Approval of the Minutes

Upon motion made and seconded, the Minutes of the Committee's Regular Meeting held on December 11, 2014 and Minutes of the Special Meeting held on December 19, 2014 were approved.

b. Appointment of the Senior Vice President – Internal Audit

Chairman Nicandri submitted the following report:

"SUMMARY

The members of the Audit Committee are requested to consider the appointment of the Senior Vice President – Internal Audit and to establish her compensation.

BACKGROUND AND DISCUSSION

Article IV, Section 2 of the Authority's Bylaws and Section C(3) of the Audit Committee Charter empower the Audit Committee to appoint the head of Internal Audit.

RECOMMENDATION

Jennifer Faulkner has been acting as the head of Internal Audit since February 17, 2015. It is recommended that Ms. Faulkner be appointed to the position of Senior Vice President – Internal Audit with an annual salary of $205,000, effective February 17, 2015."

The following resolution, as submitted by the Chairman, was unanimously approved.

RESOLVED, That pursuant to Article IV, Section 2 of the Authority's Bylaws and Section C(3) of the Audit Committee Charter, Jennifer Faulkner is hereby appointed to the position of Senior Vice President – Internal Audit with an annual salary of $205,000, effective February 17, 2015.

c. Amendments to the Authority's Audit Committee Charter

The President and Chief Executive Officer submitted the following report:

"SUMMARY

The Audit Committee is requested to approve amendments to the Audit Committee Charter set forth in Exhibits '2c-A' and '2c-A-1' of this item and to recommend its adoption to the Board of Trustees. The most significant amendments are discussed below.

BACKGROUND & DISCUSSION

The Audit Committee Charter was last amended on February 23, 2010. In December of 2014, the Audit Committee requested that its Charter be evaluated against current practice at the Authority, as well as compared to the leading practices of comparable public authorities and utilities. The objective of the review was to identify gaps in information and processes and to provide recommendations for Charter enhancement. In addition, since 2010 there have been significant changes to the organizational structure of the Internal Audit Department, including appointment of a new Chief Audit Executive on February 17, 2015.

The principal amendments to the Audit Committee Charter included in Exhibit '2c-A' are as follows:

- Enhanced explanation of Committee decision-making requirements, such as quorum and majority vote. These include provisions for: changing the number of committee members from three to no more than five; the addition of an alternate member; defining a quorum to be a majority of the number of regular Committee members; and a majority vote of the members present to take action on a matter.

- Expanded explanation of Committee responsibilities as it relates to Internal Audit, such as the authority over the appointment, dismissal, compensation and performance reviews of the Chief Audit Executive; the review of the activities, staffing and organizational structure of the Internal Audit Department, as well as elaboration on the discussion of significant risks reported in the Internal Audit reports (See Section C.3 a, b and e).

- Inclusion of Committee oversight responsibilities, as recommended by the Institute of Internal Auditors ('IIA'), such as periodic reporting to the Board, annual review of the Charter and conduct a self-evaluation (See Section C.3 j and k).

FISCAL IMPLICATIONS

None.

RECOMMENDATION

The Executive Vice President and General Counsel, the Senior Vice President – Internal Audits and I recommend that the Audit Committee approve the proposed amendments to the Audit Committee Charter."

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously approved.

RESOLVED, That the Audit Committee recommends the adoption of the Audit Committee Charter in the form proposed in Exhibit "2c-A" to the Authority's Board of Trustees.

DISCUSSION AGENDA:

3. Internal Audit Update

Audit Activity Update

Ms. Jennifer Faulkner, Senior Vice President of Internal Audit, provided an update of the Internal Audit activity to the Committee (Exhibit "3-A"). Ms. Faulkner highlighted changes that were being implemented in the Internal Audit Department ("IA"). She said the plan is to move away from the traditional approach in conducting the audits and adopt a new model to add value to the process, partnering with the Business Units, being a trusted advisor and assist them in achieving their goals and objectives. She said there are open positions within IA, including positions for two Audit Managers and two senior auditors; one position has been filled and the selected candidate will be starting in three weeks. In response to a question from Trustee Foster, Ms. Faulkner said staffing would be discussed in more detail in the executive session.

Ms. Faulkner continued that IA is in the process of completing the 2014 audits, twenty-five of which were still open. Since the last Committee meeting, IA has issued fifteen of those audit reports and one has been moved to the 2015 Audit Plan.

In response to further questioning from Trustee Foster, Ms. Faulkner said the field work on the fourteen open audits has been completed and staff is in the process of obtaining management's agreement on the findings. The anticipated completion date of the 2014 audit reports issued is the end of April and this will not impact the 2015 Audit Plan.

Ms. Faulkner then outlined certain enhancements which were made within the department such as the creation of tools for the Audit team such as open meetings, audit requests and work program templates to standardize the work that the team is performing across all audits. In addition, several changes have been made to the Audit Report format for 2015 which includes the overall report rating and the risk ranking of all findings identified during the audit in order to make it easier for staff to understand the difference between "high risk" issues that need to be addressed immediately versus "performance improvement" opportunity or "lower risk" issues that do not need to be addressed immediately.

<u>Status of the 2015 Internal Audit Plan</u>

Ms. Lynne, Coviello, Senior Manager, Advisory Services, Ernst & Young ("EY"), provided highlights of the status of the 2015 Internal Audit Plan (Exhibit "3-A"). She said two audits are currently in progress and will be completed in the near future. Twenty-five reports have been issued and eight audits are in progress. All audits will be completed by the end of April.

Ms. Anna Devine, Coordinating Partner, Advisory Services – Ernst & Young, said, after discussions with the Business Units, changes were made to the Audit Plan. Also, IA plans to work with the Business Units on a periodic basis so that IA can understand the changes being made and therefore be better informed at the time of the audits.

In response to a question from Authority Chairman Koelmel, Ms. Devine said, as indicated at the December meeting, some of the audits from the 2014 Plan were being rolled-over to 2015 due to timing issues, process changes and changes within the organization. To that end, in setting up the 2015 Plan, EY allocated time to adjust the schedule "as needed" to allow for time to complete the 2014 audits, while, at the same time, not delaying the process for the 2015 audits.

Ms. Faulkner then provided highlights of the changes and improvements being made in the IA department. She said that the IA department is facing challenges in recruiting applicants with both audit and power utilities experience; therefore, the plan is to use the standard audit model to fill the open positions with applicants who have traditional audit experience but who may not necessarily have power utilities background and provide them the necessary training through a very strong "on-boarding" process. With regard to the execution of the audits, improvements are being made by creating standard audit open meeting presentations and improving the customer feedback survey. Ms. Faulkner said she has been meeting with colleagues and stakeholders across the Business Units and they expressed differing levels of satisfaction with the audit services provided by the traditional team. The customer feedback survey, which will be tailored to provide a better understanding of what the team is doing well and areas that need to be improved, will be implemented next month. IA is also in the process of updating the Internal Audit Charter which the Committee will be requested to approve at its next meeting.

In response to a question from Authority Chairman Koelmel, Ms. Faulkner said IA will be implementing a process using four ratings for the audit reports: satisfactory; generally satisfactory; needs improvements; and unsatisfactory. The risk levels of individual audit issues will be rated as: high; medium and low. An explanation, along with examples, will also be included with each of the different levels of the audit process. In response to further questioning from Authority Chairman Koelmel, Ms. Faulkner said in addition to the summary of all the audit reports, the monthly reports will be changed to include all of the risk ratings of the audit reports so that the Committee members will be able to tell which audits they will need to focus on, going forward.

In response to a question from Trustee Foster, Ms. Faulkner said since joining IA, she has been meeting with colleagues and familiarizing herself with the processes; working with EY to understand the 2014 audits; working closely with the audit team in reviewing the audits before they are issued; participating in meetings; assessing reports; and providing feedback. She has also been reviewing the work programs; recruiting and human resource issues; and also the improvements that have been identified. Responding to further questioning from Trustee Foster, Ms. Faulkner said in relation to recruiting, she is working on bringing on additional staff that are competent, understand the business, and are able to work independently. Also, she is recruiting for all of the open positions on IA's organizational chart. In response to still further questioning from Trustee Foster, Ms. Faulkner said she is a member of the Executive Management Committee and President Quiniones has invited her to attend the meetings; this has been very helpful in her understanding the Authority's business initiatives.

In response to a question from Authority Chairman Koelmel, Ms. Faulkner said IA will require EY's services for the remainder of 2015. IA will be able to begin a process of tapering down EY's services in 2016. Trustee Flynn suggested that the Committee leave it to Ms. Faulkner's judgment to inform the members when it is appropriate to end EY's services. Trustee Foster added that EY has been doing an extraordinary job and the Committee's probe as to when the Authority will become independent of EY is not a reflection on the quality of service they are providing to the Authority. Authority Chairman Koelmel suggested that a formal work-stream be

established for the transition and asked that IA provide a work plan to that effect which can be discussed with the Committee on an ongoing basis with the view that at the end of the year an agreement can be reached as to when the transition will occur.

4. Year-end 2014 Financial Report

The Vice President and Controller submitted the following report:

"Pursuant to Section 2800 of the Public Authorities Law, as amended by the Public Authorities Accountability Act of 2005 ("PAAA"), the Authority is required to file its financial report for the year ended December 31, 2014 and submit this report to the Governor, legislative leaders, the State Comptroller and the Authorities Budget Office. The PAAA reflects the State's commitment to maintaining public confidence in public authorities by ensuring that the essential governance principles of accountability, transparency and integrity are followed at all times.

This year-end 2014 financial report includes financial statements that present the financial position and results of operations of the Authority as of December 31, 2014 under generally accepted accounting principles (Exhibit '4-A'). The report is prepared by staff and the financial statements are audited by independent accountants from KPMG LLP. As required by the PAAA, the financial reports have been certified by the Authority's Chief Executive Officer and Chief Financial Officer. After the Audit Committee's review, the 2014 financial report is scheduled to be presented for approval by the Authority's Trustees at their meeting later today. Changes of particular significance have been highlighted in the attached draft to facilitate the Audit Committee's review.

REQUESTED ACTION

It is requested that the Audit Committee recommend that the Authority's Trustees approve the financial statements for the year ended December 31, 2014."

Mr. Thomas Concadoro provided highlights of the financial statements for the year 2014 to the Committee. He said that Net Income increased by $44 million to $272 million (2014) from $228 million (2013). This was due primarily to higher production at the Niagara Project and higher prices on market-based sales into the NYISO. Increases in market energy prices occurred during early 2014 due to the severe winter weather. With regard to non-operating income, he said the variance in investment income was substantially offset by the higher contribution ($25 million) to New York State in 2014. Capital spending is projected to be $1.9 billion over the next five years with an additional $1 billion of spending on energy efficiency programs. Cash flow during the year included more than $500 million from operating activities. Mr. Concadoro also indicated that, in consultation with KPMG, amounts collected from customers for plant retirement had been reclassified to a new line item, "Deferred Inflows," on the Authority's Balance Sheet.

In response to a question from Trustee Flynn, Mr. Lurie said the rating agencies have been consistent with their statements regarding the monies the Authority contributes to the State. The primary risk factor the rating agencies look at is the history of the contributions. He added that, over the last ten years the allocations has gone up due to the State's fiscal distress, although they have moderated in the last four years. Based on its cash flow and income, he indicated that the

Authority's contribution to the State is manageable at this time; however, the Authority will need to be mindful when considering its contributions going forward.

In response to further questioning from Trustee Flynn, Mr. Lurie said, historically, the records indicates that the Authority has had contributions to the State of more than $100 million a year; to date the contribution is $90 million. Responding to still further questioning from Trustee Flynn, Mr. Lurie said the Authority's rating did not go down when the contribution to the State was over $100 million. The Authority's rating has been upgraded since that time, and one of the major factors related to that increase was the fact that the Authority has achieved a level of stability on the voluntary contributions.

Responding to another question from Trustee Flynn, Mr. Lurie said the rating agencies do not give early warning signals before they change a rating. However, they have a formal process of issuing a revised outlook either "positive" or "negative" usually one to three years before they adjust the rating. At the present time, the Authority has a "positive" outlook.

In response to a concern raised by Trustee Nicandri, Mr. Lurie said the Authority makes capital investments in furtherance of State policy where it can earn a positive return on its investment. The Authority, however, has to be cautious in its response to the State's inquiries with regard to increases to contributions where it cannot earn a positive return; this applies to any program where the Authority does not have the opportunity to earn revenue on a particular investment. Trustee Nicandri opined that the fact that the Authority's rating was improved also helped the State's rating; and Mr. Lurie added that the State being in a strong fiscal position has helped the Authority's rating and this is taken into consideration by the rating agencies. President Quiniones added that, under Governor Cuomo's leadership, the voluntary contributions have been predictable over the last five years therefore the Authority is able to plan for the amounts to be contributed. Also, language has been inserted in the budget bill indicating that monies contributed can only be used for energy and economic development related activities; this is consistent with the Authority's mission and is viewed favorably by the rating agencies.

In response to a question from Authority Chairman Koelmel, Mr. Concadoro said every two years the Authority contracts for an actuarial evaluation on its post-employment health benefits

and, as of the evaluation date this year, is 73% funded which is higher than most companies and government entities.

In response to a question from Chairman Nicandri, President Quiniones said the Authority's demographic is changing; the number of employees eligible for retirement over the next five years is still in the in the low thirty percentile. And a recent review of the demographics showed that about 38% of the employees have been with NYPA five years or less.

The following resolution, as submitted by the Vice President and Controller, was unanimously approved.

WHEREAS, the Executive Vice President and Chief Financial Officer and the Vice President and Controller have prepared, reviewed and submitted for consideration of the Audit Committee the attached financial statements for the year ending 2014; and

WHERESAS, the Audit Committee has itself reviewed the attached financial statements;

NOW THEREFORE BE IT RESOLVED, That the Audit Committee recommend that the Authority's Trustees approve the financial statements for the year ended December 31, 2014.

5. <u>Summary of 2014 Annual Audit of Financial Statements</u>

Mr. Todd Fowler, KPMG's Lead Engagement Audit Partner, presented an overview of the Authority's 2014 Annual Audit of Financial Statements (Exhibit "5-A"). He said the audit was performed consistent with the Audit Plan presented to the Committee in December 2014. KPMG will be issuing an unqualified opinion on the Authority's financial statements for the year ended December 31, 2014; an unqualified report on the Authority's compliance with the requirements of section 201.3 of the official Compliance Codes, Rules and Regulations of the State of New York and an unqualified report on the Authority's internal controls over financial reporting on compliance and other matters.

Mr. Fowler continued that, based on the procedures outlined in the Audit Plan, the estimates and judgments utilized by the Authority's management in preparing the financial statements are appropriate. KPMG did not identify any material weaknesses or significant deficiencies in the Authority's internal controls, nor did they identify any instances of non-compliance during the audit.

Mr. Fowler also stated that KPMG reviewed the actuarial reports and all of the assumptions related to determining the post-employment benefits obligations of the Authority. He reiterated Mr. Concadoro's statement in his report that new mortality tables that were applied in the actuarial valuation this year raised the Other Post-Employment Benefits ("OPEB") obligation and said this is consistent across all entities. Also, as a follow-up to Mr. Concadoro's report, he said there were two corrected audit misstatements related to the discount applied to the asset retirement obligation and moving the asset retirement obligations from regulatory liability to a deferred inflow. He said this relates specifically to GASB 65 for appropriately recording deferred inflows and outflows. Mr. Fowler ended by stating that KPMG have not identified any significant omissions or errors in disclosures; any non-GAAP accounting policies; any illegal acts or fraud, noncompliance with laws and regulations, encountered any significant difficulties during the audit, or have any disagreements with management.

In response to a question from Trustee Foster, Mr. Fowler said that KPMG will be communicating its internal control observations in writing to management who will distribute them to the committee.

In response to a question from Chairman Nicandri, Mr. Fowler said during its testing, KPMG observed that the exception reports generated by the automated billing system were not configured to include all customer categories. KPMG's observation that the processes be improved to include all customer billing categories is not a significant finding and, therefore, is not listed as a significant internal control deficiency.

6. Motion to Conduct an Executive Session

Mr. Chairman, I move that the Authority conduct an executive session pursuant to the Public Officers Law of the State of New York section §105 to discuss matters leading to the appointment, employment, promotion, demotion, discipline, suspension, dismissal or removal of a particular person or corporation. Upon motion made and seconded, an executive session was held.

7. **Motion to Resume Meeting in Open Session**

Mr. Chairman, I move to resume the meeting in Open Session. Upon motion made and seconded, the meeting resumed in Open Session.

8. Next Meeting

Chairman Nicandri said that the next regular meeting of the Audit Committee will be held on July 30, 2015 at the Clarence D. Rappleyea Building in White Plains, New York, at a time to be determined.

<u>Closing</u>

Upon motion made and seconded, the meeting was adjourned by the Chairman at approximately 11:35 a.m.

Karen Delince
Corporate Secretary