

**UTILITY FINANCIAL STATEMENTS:
CONCEPTS AND ANALYSIS**

By

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LILCO
Lawson Lundell
L.F. Rothschild
MCI
MDU
Manufacturers Hanover
Metropolitan Edison
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Minnesota Power
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NCEA
NCEL
NJ Ratepayer Advocate
NW Natural
NYNEX
NYSEG
National Fuel Gas
National Grid
New England Electric System
New England Gas
Newfoundland Power

New Mexico PSC
NiSource
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Northern Illinois Gas
Northern States Power
Northwest Central Pipeline
Northwest Territories Power
Northwestern Energy
Nova Scotia Power
Nuclear Energy Institute
NV Energy
OPPD
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Old Dominion Elec Coop
ONEOK
Ontario Power Generation
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PPL
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PSI Energy
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Pacific Gas & Electric
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Tampa Electric
Texas PUC
Toledo Edison
TransAlta Utilities
TransCanada Pipelines
Tucson Electric Power
UBS Warburg
UGI
US Generating
US State Dept - Omsk, Russia
US West
United Illuminating
United Telephone
Univ of Georgia—PULP
Univ of Idaho-PUEC
UtiliCorp
Vermont PSB
Virginia Power
Wisconsin Electric
WPS
WUTC
We Energies
Xcel
Yankee Energy

PREFACE

This programmed text will take between six and ten hours to complete. In some instances, the issues involved have been simplified in an effort to facilitate your understanding of this introduction to utility financial statements. Be sure to use a calculator or your smart phone. In order to get the most out of the program, you should attempt to answer each question before looking at the answer. Some of the questions are quite easy; others may be difficult if you are not familiar with the concepts. Do not let the difficult questions bother you. Try your best to deal with them and then look at the answer. You should verify your answer before proceeding to the next numbered question. If there are several parts to a question (labeled with letters), answer all parts before looking at the answers.

Joel Berk

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ANSWERS begin on page 64

The 10-K Report of Consolidated Edison (CE) begins on Page 82 –Selected pages only

THE 10-K REPORT

1-1 A full set of financials will be found in the 10-K report filed with the U.S. Securities and Exchange Commission (SEC). Portions of the 10-K report of Consolidated Edison (CE) begin on page 82. The pages in the 10-K have their original page numbers on the bottom. If you need a new version of Adobe Acrobat Reader go to www.adobe.com to get one for free.

Indicate the page numbers on which you find the following for CE. Use page numbers shown on the original 10-K annual report page.

- _____ a. Auditor's Opinion or Report of the Independent Registered Accountants-usually in the form of a letter to the Board of Directors and/or the stockholders from the Public Accounting firm

- _____ b. Financial Statements

- _____ c. Balance Sheet

- _____ d. Income Statement

- _____ e. Statement of Retained (Reinvested) Earnings-often included within a Statement of Common Shareholders' Equity.

- _____ f. Statement of Cash Flows

NOTE: The answers are separate from the text. Review your answers. Then proceed. Do not look at the answers until you have tried to answer the question.

1-2 Look at the Financial Data below from the CE annual report.
Is each of the following shown?

FINANCIAL HIGHLIGHTS

(in millions, except per-share information and statistical data)

| | 2011 | 2010 |
|--|----------|----------|
| Operating revenues | \$12,938 | \$13,325 |
| Income from ongoing operations | \$1,064 | \$981 |
| Earnings per share from ongoing operations | \$3.64 | \$3.45 |
| Dividends per share | \$2.40 | \$2.38 |
| Dividend payout ratio | 66% | 69% |
| Average common shares outstanding | 292.6 | 284.3 |
| Total assets | \$39,214 | \$36,348 |
| Capital expenditures | \$2,003 | \$2,209 |
| Common equity ratio | 52.5% | 50.4% |
| Return on equity | 9.5% | 9.4% |
| Market capitalization | \$18,200 | \$14,400 |
| Stock price per share — year-end | \$62.03 | \$49.57 |
| Dividend yield — year-end | 3.9% | 4.8% |
| Total shareholder return | 30.8% | 15.0% |

- a. Return on equity
- b. Earnings for the year
- c. Income from Continuing Operations (or Income before Non-recurring items)
- d. Stock price performance
- e. Forecasts of next year's earnings

f. Rate Base

g. Total return for common stockholders (shareholder return)

h. Book Value

i. Market Capitalization

We will explain some of these items at length as we proceed through this text.

THE BALANCE SHEET-AN OVERVIEW

2-1 Refer to the CE Financial Statements. The Balance Sheet on pages 71 and 72 shows a picture of the assets, liabilities and stockholders' equity at a point in time. At what two points in time are Balance Sheet amounts shown?

2-2 Notice the Balance Sheet is made up of two parts:

ASSETS

LIABILITIES AND EQUITY

The Liabilities and Equity are broken up into five categories on page 72.

Current Liabilities

Non Current Liabilities

Deferred Credits and Regulatory Liabilities

Long Term Debt

Shareholder's Equity

Capitalization is the relatively long term capital invested in the company, typically debt, preferred stock, and common stock equity. List the amounts of each type of capital below. Show all answers in millions of dollars as they are shown on the Financial Statement of this company. Answer all questions on the Balance Sheet by referring to December 31, 2011 data.

- a. Long term debt

- b. Preferred stock

- c. Common stock equity

- d. Total capitalization

2-3 The Capitalization Ratios show the percent of each type of capital in total capitalization.

a. Divide the long-term debt by the total capitalization. This is the percent of capital supplied by long-term debt (usually bonds).

b. Divide the preferred stock figure you found by the total capitalization. This is the percent of capital supplied by preferred shareholders. Round off to the nearest 1/10th of 1%.

c. Divide the common stockholders' equity by the total capitalization. This is the percent of capital supplied by common shareholders.

2-4 One element of capitalization is a liability. If we define liabilities as "amounts owed for benefits already received," which element of capitalization is a liability?

Some companies title the right hand side of the Balance Sheet as "Liabilities and Capitalization." But this is a misnomer, it should technically be called "Liabilities except long-term debt and Capitalization." The better heading used by CE is "Liabilities and Shareholder's Equity." For a company that is not investor owned (e.g., a municipal utility or coop) the Equity is not shareholders equity, but is often called equity. The term 'owner's equity' would be used to be inclusive of the equity in a partnership, proprietorship or non-investor owned company.

2-5 Common and preferred stock are not liabilities since the holders of this stock have no legal claim on the utility for any dividends. If the utility does not have the cash to pay dividends, the utility cannot be sued for these dividends. Note that Con Ed, NV Energy and other utilities have omitted their common dividends, due to financial difficulties, in the last 30 years. NV Energy did continue to pay the preferred dividends, and it is in this sense that the preferred stock has preference over the common. (Also, in the event of bankruptcy of the company, preferred shareholders will be better off.) No answer required.

2-6 The other liabilities listed (e.g., Current Liabilities and Deferred Credits) are also sources of capital for the utility but are not considered to be as permanent. Taken together, the sources of capital (the liabilities and the owners' equity) which CE has amounts to:

2-7 This capital has been used over the years to finance resources to be used in the business. These economic resources, which have benefit to the future, are called Assets. The total amount of the assets is:

2-8 The liabilities and owners' equity must be equal to the assets since the former represent the sources of the assets. The Balance Sheet must balance. Write an equation relating the terms assets, liabilities and owners' equity.

2-9 What is the largest category of assets which CE has? (This is typical of a utility.)

2-10 The organization of some utilities' Balance Sheets differ from that of a non-regulated firm. This presentation is indicative of the capital intensive nature of the industry. (For example, see the balance sheet of Atmos below). Which asset is listed first for some utilities?

ATMOS ENERGY CORPORATION CONSOLIDATED BALANCE SHEETS

| | September 30 | |
|--|-----------------------------------|--------------|
| | 2005 | 2004 |
| | (In thousands, except share data) | |
| ASSETS | | |
| Property, plant and equipment | \$ 4,631,684 | \$ 2,595,374 |
| Construction in progress | 133,926 | 38,277 |
| | 4,765,610 | 2,633,651 |
| Less accumulated depreciation and amortization | 1,391,243 | 911,130 |
| Net property, plant and equipment | 3,374,367 | 1,722,521 |
| Current assets | | |
| Cash and cash equivalents | 40,116 | 201,932 |
| Cash held on deposit in margin account | 80,956 | - |
| Accounts receivable, less allowance for doubtful accounts of \$15,613 in 2005 and \$7,214 in 2004 | 454,313 | 211,810 |
| Gas stored underground | 450,807 | 200,134 |
| Other current assets | 238,238 | 99,319 |
| Total current assets | 1,264,430 | 713,195 |
| Goodwill and intangible assets | 737,787 | 245,528 |
| Deferred charges and other assets | 276,943 | 231,383 |
| | \$ 5,653,527 | \$ 2,912,627 |
| CAPITALIZATION AND LIABILITIES | | |
| Shareholders equity | | |
| Common stock, no par value (stated at \$.005 per share); 200,000,000 shares authorized; issued and outstanding: 2005 - 80,539,401 shares, 2004 - 62,799,710 shares | \$ 403 | \$ 314 |
| Additional paid-in capital | 1,426,523 | 1,005,644 |
| Accumulated other comprehensive loss | (3,341) | (14,529) |
| Retained earnings | 178,837 | 142,030 |
| Shareholders equity | 1,602,422 | 1,133,459 |
| Long-term debt | 2,183,104 | 861,311 |
| Total capitalization | 3,785,526 | 1,994,770 |
| Commitments and contingencies | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 461,314 | 185,295 |
| Other current liabilities | 503,368 | 238,682 |
| Short-term debt | 144,809 | - |
| Current maturities of long-term debt | 3,264 | 5,908 |
| Total current liabilities | 1,112,755 | 429,885 |
| Deferred income taxes | 292,207 | 241,257 |
| Regulatory cost of removal obligation | 263,424 | 103,579 |
| Deferred credits and other liabilities | 199,615 | 143,136 |
| | \$ 5,653,527 | \$ 2,912,627 |

2-11 The Balance Sheet of CE has a presentation in a format used by non-rate regulated companies. What category of assets is listed first for a non-rate regulated company?

2-12 Which element of Liabilities and Owners' Equity is listed first for some utilities? (See Atmos on previous page) A non-regulated firm and most utility holding companies would have the Current Liabilities listed first.

2-13 There are three major categories of assets for a utility. Looking at the CE Financial Statements, can you list them?

2-14 Property Plant and Equipment usually shows the total original cost and accumulated depreciation of all of the company's plant, property and equipment which is used (or will be used in the case of Construction Work in Progress and held for future use) to supply utility services.

a. How much did CE pay for all its regulated plant in service?

b. Can you tell from the balance sheet what it would cost to replace these facilities at the Balance Sheet date? Yes or No?

2-15 The original cost of the Plant must be adjusted to show that some of the plant has been "used up." That is, some of the service life of the plant has expired. Depreciation is taken each year, to account for the amount of original cost related to the service life that has passed. Over the years, the depreciation is accumulated. It is shown on the Balance Sheet under what title?

2-16 Depreciation is taken on each piece of property comprising Electric Plant (except for land, construction work in progress and held for future use), regardless of the change in value of the property. The accountant is attempting to reduce the property asset down to its net salvage value (what it will be worth when retired from service) without considering the changes in value in the years when it is in service. Let us take a utility truck with a cost of \$60,000, a four- year life, and \$20,000 salvage value. The accountant would very often have \$10,000 per year in depreciation.

a. Fill in the spaces below for this truck.

| End of Year | 1 | 2 | 3 | 4 |
|--------------------------|--------|--------|---|---|
| Original Cost | 60,000 | 60,000 | | |
| Accumulated Depreciation | 10,000 | 20,000 | | |
| Net Book Value | 50,000 | 40,000 | | |

b. Draw a graph of the Net Book Value below (Net Book Value is the amount the asset is carried on the books: original cost minus accumulated depreciation.) Actually, depreciation takes place every minute of every day so the Net Book Value is decreasing continuously.

c. The graph is in the form of (choose one):

_____ curve _____ straight line _____ circle

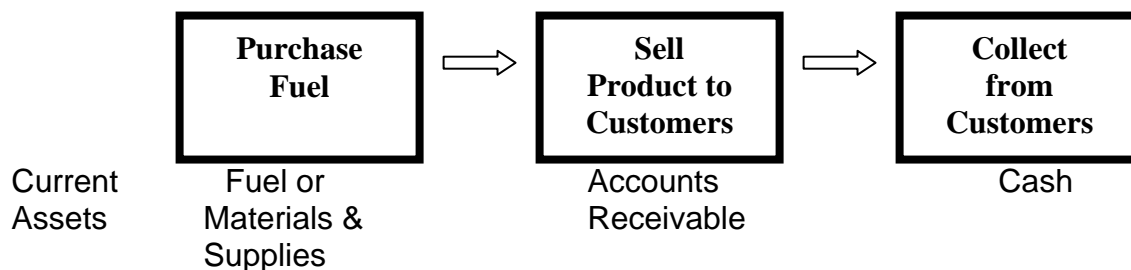
d. A good name for this depreciation method in light of the shape of the graph of Net Book Value is:

e. What Note, which begins page 88 of CE, describes this method of depreciation?

2-17 Why would the Construction Work in Progress and the Plant held for future use have no Accumulated Depreciation associated with it?

2-18 Non-utility plant relates to non-rate regulated investments. Are these substantial at CE?

2-19 Current Assets are those assets which are cash (dollars in the utility's checking accounts) or will be turned into cash during the operating cycle of the utility. The operating cycle of an electric or gas utility can be defined as the period of time from when the fuel or gas is purchased to the time collections are made from customers.



a. From the diagram above, which two assets are clearly turned into "cash" in the operating cycle?

b. The other current assets are assumed to be used up in a short period of time (in operations) and hence are turned into cash in the sense of collecting cash for the utility services they were used up in creating. The cash, cash equivalents and Accounts Receivable (amounts due from customers) are listed at what they are worth to the utility (value). Prepayments are listed at amounts paid for items which have not been used yet (like insurance paid for in advance). Are Materials and Supplies and Prepayments shown at their value or at their cost?

2-20 We all know the bookkeeping process is made up of Debits and Credits. Most of us know Debits always equal Credits. Few of us realize that Debits and Credits are completely unnecessary to the understanding of accounting. Do you see the Debits and Credits on the Balance Sheet (or on the Income Statement for that matter)?

2-21 Unfortunately, at times, some of the Debit and Credit notations creep into the Financial Statements. The Deferred Credits is one such instance. They are simply items which are not due in a legal sense of being owed, but will be paid in the future. Some Deferred Charges (also called Deferred Debits) are items, usually without physical existence, which have been paid for already, but which will generate revenue in the future. Some are assets (and have economic benefit to the future) because the rate-making process will allow the utility to recover these costs in rates in the future.

a. How much money will be collected from ratepayers for regulatory assets?

b. How much of this will be collected from the customers for environmental remediation costs (see page 102)?

2-22 Current Liabilities are those liabilities which must be paid within one year. CE has a rather complete list of these. The terms accrued and payable can be considered synonyms. Match the examples (a-d) with the title used (1-4) by CE on its Balance Sheet. Put the number of the account beside the transactions below. Each account should be used once and only once.

Account:

1. Accrued taxes
2. Long-term debt due within one year
3. Accounts payable
4. Customer Deposits

_____a. Deposits received

_____b. Amounts due suppliers for energy received

_____c. Current portion of long-term debt

_____d. Taxes owed

2-23 Which item started out as long term (non-current) liability and then changed to a current liability as amounts became due?

THE INCOME STATEMENT-AN OVERVIEW

3-1 The Balance Sheet shows the financial position of the utility at a point in time. A good alternate name for the Balance Sheet is:

3-2 The Balance Sheet does not show us what has happened during the period (usually a year or a quarter of a year). It only shows where the firm is at the end of the period. The stockholders of the firm are particularly interested in how their owners' equity (or common shareholders' equity) has changed during the year from the utility's business. They are not as interested in how owners' equity has changed from selling more stock. Notice the common shareholders' equity on page 74 is broken down into 6 parts.

Common stock

Additional paid-in capital

Retained earnings

Treasury Stock

Capital stock expense

Accumulated other comprehensive loss

3-3 Common Stock or common shares is sometimes shown in two parts, the Common Stock and APIC (Additional Paid in Capital). These two together represent the amount the common shareholders of the firm put into the business, since it began, by buying stock in the company (when the company issued new stock). The breakdown of dollars between these accounts has no real significance to us. What is the total amount the common shareholders put into CE as of 12/31/11?

3-4 The Retained Earnings component of common stock equity represents all of the earnings (Net Income) of the firm which was not given to the shareholders in the form of dividends. These retained earnings are the accumulated amounts since the firm began. To the extent the firm has these retained earnings, the common stockholders have invested more in the firm. Therefore, Retained Earnings is sometimes called:

3-5 If we want to look at the portion of owners' equity which has changed for reasons other than selling stock to shareholders, or buying stock from them, which two parts of owners' equity should we look at?

3-6 The fundamental accounting equation is $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$. Simple algebra shows us that $\text{Owners' Equity} = \text{Assets} - \text{Liabilities}$. This form of the equation is useful since it clearly shows us that when we subtract the Liabilities (amounts owed) from the Assets (economic resources which have benefit to the future) we have what is left over for the owners. If more stock is sold, assets increase (cash) and owners' equity increases but the owners are no better off. Why?

3-7 If we exclude stock sales and dividends given to the owners and then look at the change in Owners' Equity for a period of time, we will be able to determine if the owners are better off. No answer required.

3-8 The owners should be very interested in what happened to their Owners' Equity during the year. The portion of Owners' Equity most critical in this regard is the Retained Earnings. Which Financial Statement shows us in one of the columns how retained earnings increased and decreased during the year? (page 74)

3-9 What are the two items which explain how Retained Earnings has changed for CE from the beginning of the year to the end of the year?

3-10 Write an equation with the following variables to explain most of the Changes in Retained Earnings (RE).

BBRE = Beginning Balance in RE

EBRE = Ending Balance in RE

DIV = Dividends

NI = Net Income

3-11 The Retained Earnings column in the statement does not explain what makes up the most important change in Retained Earnings as far as investors are concerned. This lack of explanation has to do with the components of which of the variables in the above question (RE, DIV or NI)?

3-12 It is up to the Income Statement to supply this important information. What is the Net Income for CE for 2011?

3-13 Everything above Net Income is an explanation as to why Net Income is as shown. The Income Statement shows us why Owners' Equity changed from the business of the company. Go down the Income Statement for CE and put + or - to the left of the amount of each item to show whether this item increased the Owners' Equity (increased Net Income) or decreased Owners' Equity. (Note: you may have to look at the subtotals to figure out whether certain items have been added or subtracted.)

3-14 The Net Income figure shows us how much the Owners' Equity has changed due to the process of doing business. It is a measure of the performance of the firm in that it shows us how the firm did during the year in terms of how much better off the owners are. In order to see what has caused the Bottom Line (Net Income) to be as shown, the Income Statements show the details of the performance of the firm. (No answer required)

3-15 A firm's Income Statement is often broken up into five major sections. Looking at the Income Statement of CE, list the five major sections before Net Income.

3-16 Can you tell by looking at the Income Statement of CE which regulated business has higher Net Income?

3-17 Revenue is defined as a gross inflow of assets (e.g., cash or accounts receivable) from the operations of the company for which goods and services have been delivered to the customer during the accounting period. Which of the following are revenue items for a utility? (Check each that applies.)

- _____ a. sale of electricity
- _____ b. sale of plant to another utility
- _____ c. sale of common stock
- _____ d. sale of bonds

3-18 Often the cell phone company collects cash in December for January basic service. According to the definition of revenue, is this revenue in the year they collect the money or the next year?

3-19 Given the definition of revenue in 3-18 above, can you tell from CE's Income Statement how much cash was received from customers during the year?

3-20 The accountant uses accrual accounting for the Financial Statements. This means revenue is shown in the period (e.g. year) in which it is earned regardless of when the revenue is collected in cash. The utility shows revenue for its services when the services are delivered regardless of when the customer pays. An allowance is made for anticipated non-payments so revenue is not over-stated. Although the cash may not have been received for some of the revenue, the gross inflow of assets is in the form of Accounts Receivable. (Accounts Receivable are amounts due from customers which they will pay some time after they receive their bills.)

a. How much of CE's revenue has been billed to the customers but not collected yet that company expects to collect?

b. How much revenue did CE have in 2011?

3-21 In order to measure the performance properly, we must subtract from the revenue all of the costs necessary to get that revenue. Costs needed to get the revenue are called expenses. Expenses also follow accrual accounting. It does not matter whether these costs have been paid for or not, if they were incurred in order to earn the revenue they are expenses (to be matched against that revenue). For CE, how much in operating expenses was required to get the revenue?

3-22 CE invested \$1887 in additional plant in 2011. We can find this number on the Statement of Cash Flows on page 70. Was this the amount necessary to get the \$12,938 in revenue (yes or no)?

3-23 Should this \$1887 of new plant be considered an expense of 2011 (yes or no)?

3-24 Let us assume the \$1887 addition to plant represents one generating unit which will get the company revenue over 40 years. How much of the plant is "used up" to get the revenue each year? (Make the simplest assumptions possible.)

3-25 If we spread the cost of the plant over 40 years by showing 1/40th of the cost as an expense each year, what method of depreciation are we using?

3-26 It would not make sense to say that the amount paid for plant during the year is the depreciation expense. Doing so would be saying the whole plant was used up to get one year's revenue. This would not match revenues and expenses well and would not be _____ accounting.

3-27

a. How much is Depreciation and Amortization expense in 2011 compared to the utility plant additions in 2011?

b. Is there any apparent relationship between the plant additions and depreciation?

3-28 Which of the following best describes the Depreciation Expense figure shown on the Income Statement?

_____ a. cost of plant additions during the year

_____ b. cost of plant retired during the year

_____ c. cost of the portion of the plant "used up" during the year to get revenue

_____ d. cost of replacing the plant "used up" during the year to get revenue

3-29 The Depreciation Expense represents an allocation of a cost which could be 30 or 40 years old, when various utility plant was constructed. It might cost much more to replace the portion of plant which is used up during the year than it originally cost. The Income Statement is based on those original (historical) costs. Many users of Financial Statements feel they want to know the current cost of replacing the plant which is depreciated. Does the figure we saw on the Statement of Cash Flows (which represents the additions to utility plant) give them the information they want? Why or why not?

3-30 Another definition of Net Income is:

$$\text{Net Income} = \text{Revenue} - \text{Expenses}$$

If we use this definition of Net Income, we must force many items on a utility's Income Statement into either the Revenue or Expense category. Since we have specific definitions for Revenue and Expense, it would be best to enlarge this equation step by step and use one of the other forms. More complete forms include:

- a. $\text{Net Income (NI)} = \text{Revenue} - \text{Expense} + (\text{Gains-Losses})$
- b. $\text{Net Income} = \text{Revenue} - \text{Expenses} + \text{Other Income}$
- c. $\text{NI} = (\text{Operating Revenue} - \text{Operating Expenses}) + \text{Other Income} - \text{Interest}$
- d. $\text{NI} = \text{Operating Revenues} - \text{Operating Expenses} + \text{Other Income} - \text{Interest} - \text{Income Taxes}$

Which form most parallels the CE Income Statement?

3-31 The terms Net Income, Income, Earnings and Profit sometimes have special meanings to the people who are using them. In general, however, these are synonyms. However, the word earnings in the term Earnings per Share always means the Earnings left over after preferred dividends (i.e., Earnings for Common Shares).

a. What terms are used by CE for the Earnings and for Earnings for Common Shares?

b. Divide the average number of shares outstanding (basic) into the Net Income for Common Stock for CE. Does your answer agree with theirs?

FINANCIAL STATEMENT ANALYSIS-RATIOS

4-1 In order to make sense out of the financial statement figures, we must compare them to something. In order to see this clearly, just think about what you would know about a company if you found out its earnings per share was \$3.59 but know nothing else.

- a. Could you say its earnings were higher than last year?

- b. Could you say its earnings were higher than expected?

- c. Could you say the company was doing well?

- d. Could you say the common shareholders were earning a large amount on their investment?

4-2 One way to analyze the results of a company is to compare the company's performance from one year to the next.

- a. Which one of the financial statements helps to do this?

- b. How many years of data are given for comparison purposes?

4-3 Notice the assets used to get CE's income have increased since last year. More important than this, the amount of capital invested by the common stockholders has increased. What part of the Financial Statements shows this to us?

4-4 In order to compare earnings to the equity investment, an important ratio is used. This ratio is called return on equity (ROE). It is measured by dividing the Income available for the Common Shareholders by the average equity contributed or left in the company by these shareholders. The average of the common equity is used since this equity has a different amount at the beginning and end of each year (due to stock sales and/or Net Income and Dividends during the year).

a. Find the average of the beginning of the year and end of the year amounts of the Common Equity for CE 2011 from the Balance Sheet.

b. Divide this into the "Earnings Applicable to Common Stock" from the Income Statement to get ROE.

4-5 It is important to understand that the ROE which we just found is not the return which a common shareholder feels directly. The ROE measures the earnings for common shareholders as a percent of the dollars they gave the company or left in as Retained Earnings. It does not consider the price that shareholders are currently paying each other to own the stock. The stockholders' return for the past year is measured by the dividends these investors get plus the percent increase (or minus the decrease) in the price of their stock. This return, which is the only return which the shareholder can turn into cash, can be found from the following formula:

$$R = D/P_B + (P_E - P_B)/(P_B)$$

where R is the Return, D the dividends earned on one share of stock during the year, P is the market price (e.g. on the New York Stock Exchange) of one share of stock. (The "B" indicates "at the beginning of the year" and E "at the end.") The price at the beginning of 2011 is the price at the end of 2010. Use the Financial Highlights from question 1-2 and apply the formula to find the return for the common stockholders in 2011. This metric or measure is often called Total Shareholder Return or TSR.

4-6 Notice the return is made up of two parts: the dividends/price and change in price/price. It should be clear that if you bought a share of CE Common on 12/31/10 for \$49.57 and received a \$2.40 dividend on this, that your dividend yield is $\$2.40/49.57=4.8\%$. But you have stock, which is more valuable on 12/31/11 than when you bought it. It is worth \$62.03 on 12/31/11. You have a return of $(62.03-49.57)/49.57=25.1\%$ on the increase in the stock price. Of course, to have made this portion of the return in cash you would have had to sell the share of stock on 12/31/11. We say the return for 2011 includes this increase whether you sold it or not. The total shareholder return is $4.8\% + 25.1\% = 29.9\%$. Is the shareholders return for 2011 the same as the ROE for 2011?

4-7 One reason the accountant's ROE is not the same as the return to the common stockholders is that the market price of the stock is not the same as the common equity per share. And the earnings per share of common is not the same as the dividends plus appreciation of stock price. The market price of the stock depends on the future expectations of returns to the common shareholders (this determines what investors will pay for the stock), while the common equity per share depends on past issuance of stock, income and dividends. It is up to the equity investors to use past (historical) information about the company to decide what they are willing to pay for future dividends and price appreciation of their stock. The only return the shareholders can get is in the form of dividends and stock appreciation. Net Income, by itself, cannot be spent by the shareholders.

a. Two reasons could be stated as to why Net Income is not available to the shareholders in cash. One is that Net Income is not "cash income" because of what type of accounting?

b. The second reason concerns the difference between what the utility earns and what the shareholders get from the utility. The shareholder only receives cash from the utility in the form of _____.

4-8 The amount of dividends given to common shareholders as a percent of Net Income available to common stock is called the payout ratio. What is the payout ratio for CE for 2011? [Payout Ratio = Common Dividends per share/Earnings per Share (EPS) Basic]

4-9 If a company does not give its shareholders any cash dividends, then the shareholders will get none of their return in the form of dividends. All of their return will then be in the form of _____ .

4-10 Dividing the number of common shares outstanding on 12/31/11 into the common equity yields the common equity per share (often called Book Value). Using information from pages 72 and 75, what is the Book Value as of 12/31/11 for CE?

4-11 The book value represents the average amount which previous investors paid for stock issued by the company or which previous investors' earnings were retained by the business. The common shareholders set the market price of the stock by buying and selling at that price. This market value may be higher or lower than the book value of the company. When the market value is higher than the book value, it means common shareholders are willing to pay more for a stock than the average amount which previous shareholders have invested or left in the company.

4-12 Another important ratio is Times Interest Earned. Similar ratios are called the Fixed Charge Coverage Ratio or Pretax Interest Coverage Ratio. These ratios can be defined in many ways, one of the simplest being Income before Interest and Income Taxes by divided by Interest Expense. The interest cost is before any AFUDC. This will show the safety margin for meeting the fixed payments for interest.

For CE, fill in the chart below from the Income Statement:

| | |
|---------------------------------------|-------|
| Income before Interest and Income Tax | _____ |
| Divided by Interest Expense | _____ |
| = Times Interest Earned | _____ |

4-13 The Price Earnings Ratio compares the market price of the stock to the EPS. The current stock price and the EPS for the previous 4 quarters is usually used. What is the PE ratio for CE if we use the stock price as of 12/31/11? (Divide Market Price by EPS diluted for 2011).

4-14 The Chart shows data from February 22, 2013. Why is the P/E different than the answer to the last question?

| SYMBOL | NAME | 52-WK RANGE | | PRICE | EPS | P/E |
|-------------|--------------------------|-------------|--------|---------------|-------|-------|
| T | AT&T, Inc. | 29.95 | 38.58 | 35.68 | 1.25 | 28.54 |
| ED | Consolidated Edison Inc. | 53.63 | 65.98 | 58.48 | 3.86 | 15.15 |
| GOOG | Google Inc. | 556.52 | 808.97 | 799.71 | 32.21 | 24.82 |

4-15 Which has the highest PE of the three Companies shown above? What is the most likely explanation for this?

4-16 The market price (P) of a stock is set by the stock market (equity) participants. They are looking at the future dividends and stock price appreciation. These dividends and growth in the stock price depend on the future profits of the company. If the company is expected to have a higher EPS in the future, these market participants will be willing to pay more for the stock than if EPS were expected to remain constant. Differing expectations of future EPS growth for the three companies may well be the main reason for the market being willing to pay a higher multiple of earnings for one company than for another. Look at the PE ratios for the two non-regulated firms listed under (4-15) as compared to the PE's of CE. Why are investors willing to pay so high a P/E to own these non-regulated firms as compared to regulated utilities?

4-17 Many other ratios are useful. Each ratio allows us to standardize the accounting figures so as to compare them to something. You could create your own ratios for this purpose. For example, if you wanted to see if CE had operating expense which appeared out of line with other utilities, you could compare the operating expense of some utilities.

a. Find the Total Operating Expenses for CE.

b. Why is the absolute number not meaningful?

c. You can divide this number by the revenue to standardize it. Calculate that ratio for CE.

STATEMENT NOTES

5-1 What statement is made at the bottom of each of the financial statements of CE concerning the notes?

5-2 The Notes to the financial statements are critical to understanding the statements. These Notes contain four types of information:

1. Explanation of accounting methods used
2. Information about assumptions and estimates used in applying the accounting methods
3. A more detailed breakdown of the figures shown on the financial statements
4. Disclosure of important (material) information not shown in the financial statements

Although many of the Notes contain combinations of the above types of information, try to label each of the following Notes of CE with one and only one of the information types listed above.

Note A _____

Note H _____

Note B _____

Note I _____

Note C _____

Note J _____

Note D _____

Note K _____

Note E _____

Note L _____

Note F _____

Note G _____

5-3 The Notes are a very important addition to the financial statements because of which of the following (more than one may be correct)?

- a. The Notes tell us about information not included on the financial statements themselves
- b. The Notes show us which financial statement figures are wrong
- c. The Notes allow us to understand what some of the accounting figures mean
- d. The Notes summarize the figures on the financial statements

5-4 A section on the Significant Accounting Policies used by the company is required (pages 88-92). For each of the following terms indicate in which section of the notes this is discussed:

1. Asset write downs

2. Retirement of plant

3. Temporary differences between the financials and tax

4. Allowance for funds used during construction

5. Rate Regulated Accounting

5-5 Most rate regulated utilities follow rate regulated accounting. With reference to the note on page 88, which businesses of CE follow rate regulated accounting?

5-6 When a cost is capitalized it is considered an asset and not an expense. Identify whether the company has capitalized (c) or expensed (e) each of the following: (See page 89)

___ a. Financing Costs of Construction

___ b. Maintenance of Plant

___ c. Construction Overhead Costs

5-7 What items are included in the cost of plant in addition to the usual construction costs?

5-8 Which item on the balance sheet is increased by the Allowance for Funds Used During Construction (AFUDC or AFDC)?

5-9 Regulatory assets are typically costs which would have been an expense at a non-regulated firm but are assets at the regulated utility. The regulators (public utility commissions) create these assets by allowing the utility to collect these amounts through future rates.

a. How can CE have a regulatory asset for “Deferred derivative losses” (see page 102) when these were losses?

b. “Recoverable Energy Costs” are described on page 90. How do these create regulatory assets (or liabilities) and what amounts are shown on page 102?

5-10 On the Financial Statements, CE used different methods of accounting and different accounting estimates than on their tax return. Many of these differences create deferred taxes. Looking at the chart on page 120, which item appears to create the biggest difference?

5-11 Most plant assets use accelerated depreciation (so called return since the company is allowed more depreciation expense in earlier years than later years) on the tax return as well as shorter life estimates. The accounting methods and estimates used on the US tax return are established by the Congress of the United States with implementation being left to the Internal Revenue Service. (No answer required.)

5-12 The fact that the accounting methods and estimates used for tax purposes are different than the methods used for rate regulation and financial statement purposes, will mean that the taxable income on the company's tax return will not be the same as the pretax income which can be derived from the Income Statement. Which number would the company like to be higher-pretax income or taxable income? Why?

5-13 Accounting methods used for financial statements issued to the public (like the financial statements contained in the Annual Reports) are called Generally Accepted Accounting Principles (GAAP). At the present time, a private group called the Financial Accounting Standards Board (FASB) makes these rules for US GAAP while the International Accounting Standards Board make GAAP rules followed by most other countries. In the US the FASB has been allowed to make the rules by a government agency, the Securities and Exchange Commission (SEC).

What change did the FASB make to Accounting Standards Codification 820 (ASC refers to the detailed GAAP rules on different topics) and why? (See page 135)

5-14 Will a company's tax return change due to the FASB's change in GAAP?

5-15 Which Public Utility Commission regulates CECONY's utility business? (See page 92)

5-16 Each state has a Public Utility Commission (PUC) which specifies accounting methods to be used for rate regulation purposes. Do you think the state and federal commissions which regulate rates must use the accounting methods which the other groups like the Congress or the FASB specify?

5-17 The Public Utility Commissions use the accounting methods which they feel are best. Very often the PUCs use the same methods as GAAP. When the PUCs choose a non-GAAP method, Rate Regulated Accounting (ASC 980) says the utility should deviate from the usual GAAP and follow the PUCs' method when necessary to match the expense with the revenue. Read the note in the second paragraph under Accounting Policies (page 88) What kinds of assets and liabilities are created when the PUC varies from normal GAAP?

5-18 The Auditor's Opinion or Auditor's Report which begins on page 68, is not a part of the Notes but is a statement from the Independent Public Accountants concerning the financial statements. The opinion for CE is a clean opinion. No material problems with the audit or the statements have arisen. Which of the following did PricewaterhouseCoopers do? (choose 3):

- _____ a. examined the financial statements
- _____ b. prepared the financial statements
- _____ c. chose the methods of accounting to be used
- _____ d. checked to see if GAAP were followed
- _____ e. used auditing procedures to test the accounting records
- _____ f. told the company how to check the accounting records

5-19 PricewaterhouseCoopers LLP are registered "public" accountants (CPA) in the same sense that an investor owned utility is a public utility. They both provide a service to the public. The CPA, by rendering an opinion on the financial statements, gives the investor confidence that these financial statements are not misleading or fraudulent. Match the following one for one to describe the Independent Certified Public Accountant:

- _____ I. Independent a. serves investors and others outside the company
- _____ II. Certified b. is not an employee of the company
- _____ III. Public c. passed an examination & other criteria satisfied
- _____ IV. Accountant d. one who understands accounting

THE ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

6-1 A utility is usually not allowed to charge its ratepayers (customers) for any of the costs of utility plant which is being built (until that plant provides utility service). This Construction Work in Progress (CWIP), however, needs to be financed by selling stock and bonds or retaining the earnings of the common shareholders. The costs of this financing during construction will be collected from the ratepayers when the plant is in operation. In order to accomplish this, the cost of the plant is increased to include the financing costs during the construction period. When the ratepayers pay for the cost of the plant, they are also paying for the financing costs during the construction period. The above discussion would indicate that the CWIP figure on CE's Balance Sheet includes which of the following costs (choose all that apply):

- a. anticipated maintenance costs
- b. costs of financing the CWIP to date
- c. labor costs to build the plant
- d. real estate taxes on the land under the plant

6-2 The costs of financing the construction (the AFUDC) are added to one of the utility's assets, CWIP. The fundamental accounting equation tells us that if assets increase, liabilities or owners' equity (OE) must increase. In this case, no liability is created, hence, OE must increase. The common shareholders are better off since they have more assets and no additional liabilities. Net Income is the change in OE when shareholder transactions are excluded. Since OE has gone up due to the capitalization of the AFUDC, the firm has Net Income. Label each of the following as True or False:

- a. AFUDC increases both the assets of the utility and the Net Income
- b. The CWIP is a more valuable asset due to AFUDC because rates will be set in the future to recover these AFUDC costs.
- c. Abbreviations for AFUDC are AFC and AFDC.

6-3 Revenue is shown as a part of Net Income even when this revenue has not yet been collected in cash. As long as this revenue increases an asset (e.g., accounts receivable), income is shown. What basic concept of accounting forces us to show income, even though the cash has not been collected?

6-4 The AFUDC income, which a utility shows on its Income Statement, is represented by an increase in an asset, CWIP. The cash will be received for this increased asset as the ratepayers pay for this AFUDC in future years. The income is shown now and not in later years when this cash is collected. What basic concept of accounting calls for showing the income although the cash has not yet been received?

6-5 The biggest problem with the AFUDC income is that AFUDC is a non-cash income item. The cash for the AFUDC will not be seen for many years. It will be collected over the life of the plant (e.g., 20 to 30 years) and will not start to be collected until the plant is in use. Can the utility count on this AFUDC income to finance its continuing construction program?

6-6 The AFUDC, if material in amount, is required to be shown on the Income Statement of an electric utility in two parts: the debt portion and the other (preferred and equity) portion. How much is the AFUDC – Debt and AFUDC --Equity for CE?

6-7 The Income Statement for Detroit Edison is on the next page. Add together the two parts of the AFUDC shown for 1987 in order to get the total AFUDC. Be careful to notice that both numbers increase income although one is shown as a negative number. Of the total Earnings on Common Shares for Detroit Edison in 1987, what percent is made up of AFUDC?

Consolidated Statement
of Income

| | Year Ended December 31 (Thousands) | | |
|---|------------------------------------|---------------------|---------------------|
| | 1989 | 1988 | 1987 |
| Operating Revenues | | | |
| Electric | \$ 3,171,456 | \$ 3,070,724 | \$ 2,825,910 |
| Steam | 31,575 | 31,448 | 30,821 |
| Total Operating Revenues | \$ 3,203,031 | \$ 3,102,172 | \$ 2,856,731 |
| Operating Expenses | | | |
| Operation | | | |
| Fuel | \$ 820,765 | \$ 846,678 | \$ 813,376 |
| Other power supply | 142,240 | 146,773 | 47,814 |
| Other operation | 514,017 | 521,152 | 441,046 |
| Maintenance | 291,365 | 275,610 | 245,736 |
| Depreciation and amortization | 364,554 | 325,423 | 237,325 |
| Deferred Fermi 2 depreciation | (35,234) | (44,143) | — |
| Taxes other than income | 225,763 | 212,656 | 179,308 |
| Income taxes | 129,626 | 89,944 | 159,488 |
| Total Operating Expenses | \$ 2,453,096 | \$ 2,374,093 | \$ 2,124,093 |
| Operating Income | \$ 749,935 | \$ 728,079 | \$ 732,638 |
| Other Income and Deductions | | | |
| Allowance for other funds used during construction | \$ — | \$ 1,663 | \$ 136,452 |
| Deferred Fermi 2 return | 107,169 | 134,264 | — |
| Other income and deductions | 675 | (789) | (3,435) |
| Income taxes | 843 | (769) | 663 |
| Disallowed plant costs | — | (875,372) | — |
| Accretion income | 50,188 | 25,866 | — |
| Income taxes — disallowed plant costs and accretion income | (17,047) | 225,171 | — |
| Net Other Income and Deductions | \$ 141,828 | \$ (489,966) | \$ 133,680 |
| Income Before Interest Charges | \$ 891,763 | \$ 238,113 | \$ 866,318 |
| Interest Charges | | | |
| Long-term debt | \$ 444,204 | \$ 451,415 | \$ 417,474 |
| Amortization of debt discount, premium and expense | 4,368 | 4,593 | 3,626 |
| Other | 20,980 | 20,663 | 23,459 |
| Allowance for borrowed funds used during construction (credit) | (3,740) | (3,224) | (133,215) |
| Net Interest Charges | \$ 465,812 | \$ 473,447 | \$ 311,344 |
| Income (Loss) Before Cumulative Effect of Accounting Changes | \$ 425,951 | \$ (235,334) | \$ 554,974 |
| Cumulative Effect for Years Prior to 1988 of Accounting Changes for (Notes 4 and 5): | | | |
| Disallowed plant costs and abandonments (net of income taxes of \$111,257,000) | — | (344,147) | — |
| Unbilled revenues (net of income taxes of \$40,912,000) | — | 61,367 | — |
| Property taxes (net of income taxes of \$101,306,000) | — | 139,288 | — |
| Net Income (Loss) | \$ 425,951 | \$ (378,826) | \$ 554,974 |
| Preferred and Preference Stock Dividend Requirements | 37,018 | 49,757 | 78,240 |
| Earnings (Loss) for Common Stock (Note 5) | \$ 388,933 | \$ (428,583) | \$ 476,734 |
| Common Shares Outstanding — Average | 146,816,363 | 146,761,458 | 146,729,292 |
| Earnings (Loss) Per Share | | | |
| Before cumulative effect of accounting changes | \$2.65 | \$(1.95) | \$3.25 |
| Cumulative effect for years prior to 1988 of accounting changes for: | | | |
| Disallowed plant costs and abandonments | — | (2.34) | — |
| Unbilled revenues | — | 0.42 | — |
| Property taxes | — | 0.95 | — |
| Earnings (Loss) Per Share (Note 5) | \$2.65 | \$(2.92) | \$3.25 |

(See accompanying Notes to Consolidated Financial Statements.)

6-8 The above results indicate how significant AFUDC may be for a utility. If a utility had a large percentage of income as AFUDC, it would be in a form which cannot be used to pay dividends, interest or construction costs. Theoretically, however, this income is just as good as any income, it is just not in cash now. What two things must happen before this income can be collected in cash? (Hint: what must be the status of the CWIP and what must the regulators do?)

6-9 With a large percentage of AFUDC to Earnings, the uncertainty associated with the completion and regulatory action with respect to the full recovery of construction (and AFUDC) costs causes investors much concern. If the construction were to be stopped, or once construction is completed it is not at all clear whether the ratepayers would have to pay the total costs for the plant or whether the common shareholders would have to take a loss on the plant (in the form of lower assets and owners' equity). (No answer required.)

6-10 Investors look upon AFUDC income as lower quality income. Other things being equal, we would expect utilities which have substantial AFUDC to have PE ratios which are different than the PE ratios for utilities with little or no AFUDC. Which utilities would have higher PE ratios?

6-11 Some of the financial ratios which are used are sometimes calculated without considering the AFUDC. Would it make sense to exclude the AFUDC when we calculate a Times Interest Earned Ratio? Why?

6-12 Theoretically, the amount of AFUDC should be determined by the costs of financing the CWIP. However, this figure is not easily obtained and different methods are used to make an approximation. Each PUC decides what the AFUDC rate will be. What was the rate used by CECONY for 2011? (See page 88)

6-13 Sometimes ratepayers are required to pay the financing costs before construction is completed. This is accomplished by putting the CWIP into the rate base (the assets on which the utility is allowed by the PUC to earn a return). No AFUDC is needed when the revenue of the utility is made higher in order to give the utility its financing costs during the construction period. When CWIP is in rate base, the utility receives revenue in cash rather than AFUDC in the form of uncertain, future cash. Do you think CE has all of its CWIP in rate base?

INCOME TAX

7-1 Determining income tax expenses for rate regulation purposes is very controversial. Congress and the IRS specify which accounting methods can be used for the preparation of the corporation's tax return. There are substantial tax breaks built into the tax code for buying or constructing plant (e.g., bigger depreciation than is appropriate for the portion of asset used up). Should the PUCs use these same methods of accounting when they are setting rates, if their goal is to best measure expenses?

7-2 The PUCs and GAAP specify different methods of depreciation and different life estimates for plant than the ones the IRS uses. In most cases, the utility will show lower income on its tax return than on its income statement due to what are called temporary differences. A major type of these temporary differences are timing differences. The timing of revenues or expenses is different (different years) between the tax return and the income statement. For example, using the Modified Accelerated Cost Recovery System (MACRS) under the tax code the amount of depreciation each year which can appear on the tax return for Research & Development Equipment is different from the straight line depreciation used for financial statements. The depreciation expense each year in the two statements for a piece of equipment whose cost is \$1,000,000 with salvage value of zero and whose life is expected to be ten years is:

| | STRAIGHT LINE YEAR DEPRECIATION | ACCELERATED DEPRECIATION (MACRS) |
|----|------------------------------------|-------------------------------------|
| 1 | \$100,000 | \$200,000 |
| 2 | 100,000 | 320,000 |
| 3 | 100,000 | 192,000 |
| 4 | 100,000 | 115,200 |
| 5 | 100,000 | 115,200 |
| 6 | 100,000 | 57,600 |
| 7 | 100,000 | 0 |
| 8 | 100,000 | 0 |
| 9 | 100,000 | 0 |
| 10 | 100,000 | 0 |

a. What is the total amount of depreciation expense over the ten year period for financial statement purposes?

b. What is the total amount of tax depreciation over the ten years?

c. How do you explain the fact that the total depreciation is the same regardless of which accounting method is used?

d. In what sense is the difference in the financial statement depreciation versus tax depreciation a timing difference?

e. How does the use of the accelerated depreciation push off paying taxes? (This excess of the accelerated depreciation over straight line depreciation creates deferred taxes.)

f. In what way do the deferred taxes turn around and have to be paid?

7-3 Under GAAP, the timing differences (which cause a problem in ratemaking,) are one very important category of what are referred to as temporary differences. The term temporary differences is derived from a focus on the balance sheet differences between tax and book (GAAP). For example, the \$1,000,000 plant asset would have a net book value and a tax basis (basis is the tax term for net book value of plant) of \$1,000,000 when purchased and zero at the end of ten years but in the intervening years the net book value and tax basis would differ. After year one the GAAP net book value would be \$900,000 but the tax basis would be \$800,000; there is a temporary difference between book and tax. The focus here, usually in ratemaking, is on this type of temporary differences which could be called a timing difference, since it is due to the timing of the depreciation expense.

Let us assume a small company owns only the one asset described above. The firm is able to lease out this piece of equipment for \$250,000 per year to various firms over the ten years. Assume no expenses other than depreciation and tax expense and a tax rate of 35%.

Fill in the Income Statement and Tax Return below for year one in thousands of dollars. Note the different terms used.

| INCOME STATEMENT(\$1000) | TAX RETURN(\$1000) |
|--------------------------|----------------------|
| Rental Revenue _____ | Rental Revenue _____ |
| Depr. Expense _____ | Depr. Expense _____ |
| Pretax Income _____ | Taxable Income _____ |
| Tax Expense _____ | Tax Due _____ |
| Net Income _____ | |

7-4 If you put \$17 for Tax Expense, you were using a method of accounting for timing differences called Flow Through. The Flow Through method is interesting because it is required by some PUCs and is simple. The Tax Expense is simply the tax due for the year as shown on the tax return. The name Flow Through derives from the fact that this method of accounting flows through the benefit of the tax break (more expenses on the tax return hence lower tax, in early years) to the ratepayers. Rates are set to include tax expense. If tax expense is lower, rates are lower. If the Flow Through method were to be used there would be little benefit to the utility common stockholders of using the accelerated rather than straight line depreciation. Why?

7-5 Flow Through is not allowed for ratemaking purposes for those timing differences due to the use of the Accelerated Cost Recovery System or MACRS on the federal tax return. Congress, in 1981, forced the PUCs to allow the utilities to "keep" the tax benefits of the ACRS and MACRS depreciation.

The alternative accounting method for the timing differences (called the liability Method) is usually called normalization in the utility industry. Normalization gives the ratepayers the tax break (through lower rates) over the regulatory life of the MACRS equipment. Normalization allows the utility to keep the cash tax savings until given to the ratepayers (since the utility has extra cash due to this tax break, rate base is often reduced by this interest free capital). Normalization refers to using the normal amount of tax expense which goes with the Pretax Income shown on the Income Statement or calculated for ratemaking purposes.

a. For our simple example and using the Flow Through method, what is the ratio of Tax Expense to Pretax Income? (Remember, when we use the Flow Through method, the Tax Expense is the Tax Due.)

b. This amount does not look normal since the tax rate is 35%. In order to get a normal amount of tax expense, what amount would be needed? This is the tax expense using normalization.

c. The normalization method uses the Pretax Income on the Income Statement to find Tax Expense. The actual tax due is not relevant. In this simple situation, the Pretax Income is simply multiplied by the tax rate to get the Tax Expense. The Tax Expense figure can now be thought of as being made up of two parts. Match the names of these parts with the appropriate descriptions:

- | | |
|--------------------------------|---|
| _____ I. current tax expense | A. tax not due until the timing difference turns around |
| _____ II. deferred tax expense | B. tax due |

d. How does accrual accounting help us justify the showing of tax expense as a figure different than the amount paid or to be paid soon?

7-6 When using the liability or normalization method, the tax expense is in part paid currently (i.e., cash is reduced or a taxes payable liability created to be paid in cash soon) and in part deferred. The deferred part of the tax expense is shown as a deferred tax liability. If a company had tax expense of 52.5 but the current portion was only 17.5, how much would the deferred tax liability increase?

7-7 The deferred tax liability is a strange sort of liability since the tax is really not owed to the government. As far as the IRS is concerned, the only tax due is the current portion of the tax expense; that is, the figure which shows up on this year's tax return. For this reason, the deferred tax liability is often referred to as a deferred tax credit. (Beware the term credit. In general, credit does not refer to something good. In this case, it represents dollars to be paid in tax in the future.) What does CE call the Deferred Tax Liability on its Balance Sheets?

7-8 It is possible to have a deferred tax asset on the Balance Sheet, but this is usually not a large amount for a utility. Deferred tax liabilities come about when temporary differences in assets or liabilities between the tax and book balance sheets result in paying taxes later rather than earlier. A deferred tax asset is created when the opposite occurs. That is, a deferred tax asset is created when expenses appear on the Income Statement before they appear on the tax return. Does the utility like to create deferred tax assets? Why?

7-9 CE shows Income Tax on one of the last lines on the Income Statement. This income tax expense includes both federal and state income taxes. What is the total income tax expense for 2011?

7-10 Is the total Income Tax a good approximation for the amount of tax the company is going to pay for the year? Why?

7-11 The company must tell how much it owes in taxes to the IRS (and often the state or foreign governments) and to reconcile this amount due with the tax expense figures on the Income Statement. This reconciliation is not in the same format from company to company. They are often very difficult to untangle. However, you can usually locate the current portion of the tax by looking for the word current. How much Federal and State Income Tax does CE have to pay for 2011? (See page 119)

7-12 The company in the financial statements must explain two specific items of concern (if these items are material in amount). One of these items is a reconciliation of how much tax the company has to pay versus the tax expense which show up on the face of the Income Statement. This reconciliation may not be labeled very well. Which of the three charts on page 119-120 contains this reconciliation? Hint: It obviously must contain the current tax figure if it is to reconcile this to tax expense.

7-13 What does the bottom line in this chart represent?

7-14 Looking at the first chart on page 120 we can get some insight into what has caused the deferred tax liabilities. The causes of these timing differences are important to us. What are the three largest causes of the deferred tax liabilities?

7-15 If the timing difference, in aggregate, does not turn around, then these taxes are not paid. Stating this a different way, although the deferred taxes due to the older plant turn around, and are paid, new deferred taxes are created by new plant to offset these depreciation timing differences.

Do the timing differences caused by largest three items appear to be turning around?

7-16 The fact that some of the timing differences in total may never turn around indicates a liability on the Balance Sheet may be too big and an expense on the Income Statement may be too big as well. What items are these?

7-17 By analysis, we could adjust the tax expense on the Income Statement for CE. If we felt the 2011 additional tax due to the plant difference would not be paid in the future and should therefore not be an expense, by what amount would Net Income change?

7-18 One other reconciliation is also required in the financial statements if material in amount. This disclosure, which usually takes the form of a chart, explains why the tax expense figure (the number included in Net Income on the face of the Income Statement) is not equal to the federal tax rate times pretax income. In other words, if you take the pretax income (income before tax) from the Income Statement figures and multiplied this by 35%, the chart explains why this result differs from the tax expense. For CE this is the second table on page 120.

a. One reason that tax expense differs from the statutory (by statute or law) rate is the method of accounting for the temporary differences which we saw earlier. What method may be used for some of the temporary differences if they are unrelated to the tax depreciation differences?

b. A second reason is that some of the pretax income is either not tax deductible or is a tax in addition to the federal (eg. State taxes.) What item of this nature is shown in the chart?

7-19 We have been seeing the Investment Tax Credit (ITC) without an explicit discussion of what it is and how we account for it in rate making and financial reporting. If a business firm purchased or constructed qualified equipment (e.g. new utility plant but not buildings), a credit against tax due of up to 10% of the cost was allowed under the tax law. This credit was taken on the tax return for the year in which the equipment was put into service (or during construction in some cases). For rate making purposes, the Economic Recovery Tax Act of 1981 forced the Public Utility Commissions to normalize this tax savings. Although ITC was eliminated in the Tax Reform Act of 1986, it was reintroduced for certain renewable generating plants with a 30% credit. The ratemaking treatment of these credits causes them to be relevant.

a. The term "normalization" was used in our discussion of timing differences. When used in that context, did normalization flow the tax savings through to the ratepayers?

b. The tax savings from the ITC is also not flowed through to the ratepayers but is spread (normalized) over the life of the equipment. (This is the life used for regulatory not tax purposes.) If a utility had purchased \$10,000,000 of qualified equipment, how much would the ITC on the tax return be? (Assume the utility was entitled to and took the maximum ITC.)

c. If the equipment had a 30 year life for ratemaking purposes, how much of the ITC would be amortized for ratemaking and financial reporting purposes each year?

d. This amortized amount will reduce income tax expense and therefore rates each year for how many years?

e. The remainder of the ITC (i.e., that portion not yet amortized) will be deferred ITC on the Balance Sheet (a liability). This regulatory liability has the interpretation of the amount of ITC's which will be returned to the ratepayers in later years. How much will this be after the first year of amortization?

7-20 One other area of accounting for income taxes is relevant for some utilities. The tax code allows a net operating loss carryover (NOLCO). If a firm has a loss on its tax return, it can use this loss to get a refund of taxes paid in prior years (going back 2 years maximum) and/or offset taxes due in future years (up to a maximum of 20).

The carrybacks mean a refund of taxes is forthcoming from the IRS. Do you think these carrybacks should be included in Net Income in the year of the loss? Why?

7-21 The benefit of the tax loss carry forward (TLCF) will be included in the Net Income if the company believes it is probable that it will be profitable for tax purposes in the future such that it can use the TLCF. No answer required.

ACCOUNTING FOR DERIVATIVES, HEDGING AND ENERGY TRADING ACTIVITIES

8-1 In recent years, the FASB has been concerned about the cost basis of accounting, especially with respect to trading activities where the market value of assets could be determined.

Although most assets and liabilities follow the cost basis of accounting, which of the two liabilities have names which clearly show that these liability's balance sheet values are changed to market value at each balance sheet date?

8-2 GAAP accounting requires showing values on the Balance Sheet for derivatives. A derivative is a financial instrument which derives its value from some underlying value. For example, an option to buy stock derives its value from the price of the stock. The stock option is a derivative. Why does CE use derivatives? See page 127 .

8-3 Under GAAP there are six different ways of accounting for derivatives. The accounting treatment depends on why the derivative contract was entered into and in the case of hedge contracts, whether the hedge "works" (an effective hedge.) Does this sound complex?

8-4 For utility companies, the most common reason for entering into contracts which might look like derivatives, is to buy energy, fuel, gas, etc. for their customers, or to sell product to their customers. These contracts illustrate a major exception to market-to-market accounting which is referred to as the normal purchases or sales exception. These contracts follow settlement (or accrual) accounting. (No answer required)

8-5 The second reason that the derivative was entered into would be for speculation or energy trading. If the derivative does not qualify for settlement accounting nor as an effective hedge, the accounting would also be done as described here. A simple illustration of how we value energy trading contracts would be a forward contract (a contract to buy in the future) for energy. Assume CE signs a contract in November 2011 to buy 10,000 MWH of energy for delivery during March, 2012 at a price of \$50/MWH. On 12/31/11, energy for delivery during the same month in 2012 is selling for 60/MWH.

a. What would be the value of this contract?

b. For this one contract, what would the asset for energy trading activities be as of 12/31/11?

The name of the derivative asset on the summarized Balance Sheet of companies varies. What is the amount of the net derivatives asset for CE as of 12/31/11? See page 128.

8-6 Any gains or losses due to these energy trading activity contracts must be shown in Net Income. These gains and losses are measured as the change in the value of the assets during the quarter or during the year. What would be the impact on Earnings before tax of the energy trading contract in the last example for 2011?

8-7 For a simple example of an energy trading liability, assume as of 12/31/11, the fair value of a contract to buy energy to be delivered in March 2012 is \$35/MWH. The company has a contract to buy at a price (\$50) which is higher than the current forward price (\$35) of this commodity.

a. Under mark-to-market accounting, how much would the Energy Trading Liability be?

b. What would be the 2011 loss before tax?

8-8 Many derivative instruments follow mark-to-market accounting. Important exceptions are normal purchases or sales contracts executed in the ordinary course of business with probable future delivery. The company will need to determine for each of its contracts or financial instruments whether they are derivatives under the GAAP rules.

a. Would a contract to buy natural gas for five years at a fixed price in order to use for generation at the electric utility or deliver to customers at a gas distribution company use mark-to-market accounting? Why?

b. The contracts that CE shows amounts for in the tables of page 117 would meet the “normal purchases” exception. Why?

8-9 Although most derivatives will be shown on the Balance Sheet at fair value in the same manner as energy trading contracts or equities securities the change in the value of the derivatives will not always be included in the Net Income of the Firm. Each derivative needs to be classified into one of the following categories to determine whether the change in value ends up in Net Income. The six categories are:

1. Normal sales of purchases exception
2. Speculation or ineffective hedge
3. A fair value hedge
4. A cash flow hedge
5. A hedge where the gain or loss goes to the ratepayers through a fuel or gas adjustment clause
6. A foreign currency hedge

8-10 A fair value hedge is a derivative which offsets a company's exposure to the changes in the fair value of one of their assets, liabilities or an unrecognized commitment. For example, a forward contract to sell energy at a fixed price could be entered into hedge a purchase commitment to buy energy at a fixed price. To perfectly hedge a commitment to buy 10,000 MWH at \$50 in March 2014, what kind of contract could be entered into?

8-11 For fair value hedges, the derivatives and hedged asset, liability or commitment will be marked-to-market. If the hedge is effective, there will be no gain or loss. If the hedge is not effective, the gain or loss goes to the net income. Notice that a fair value hedge of a purchase commitment will require that purchase commitment to be shown at value in the Balance Sheet.

8-12 A company has natural gas in storage at a cost of \$5/MCF. If the value of the gas goes up to \$7, the company will have an unrealized gain of \$2, but if the value were to drop to \$4, it would have an unrealized loss of \$1. To hedge against this fair value change, the company could enter into sales contract to sell gas at a fixed price. If the value of the gas goes up, this contract would decrease in value by the same amount as the gas increases in value, hence hedging the firm's exposure to the fair value changes. Notice that the gas in storage will have to be on the Balance Sheet at Fair Value if this value is hedged. Assume a company has 10,000 MCF of gas in storage with a cost of \$5 and a future contract to sell 10,000 MCF of gas at a fixed price. If the value of the gas goes up by one dollar, the fair value of the contract drops by 10,000. What is the gain or loss for the company?

8-13 Another type of hedge is a cash flow hedge. This type of hedge protects the firm from variability in future cash flows. For example, the firm may be concerned that the cost of buying gas in the future will be higher than today's price, hence requiring higher cash flows going out of the company. By entering into an option to buy gas at a fixed price, the firm could hedge the risk for these cash flow hedges. The portion of the hedge which is effective does not go into Net Income, but bypasses the Income Statement and is included in Other Comprehensive Income. (The ineffective portion of the hedge goes into Net Income). When the hedged position is closed out (e.g., when the gas is purchased), if the cost of gas is higher, the value of the option should have gone up by the same amount (for a perfect hedge). Both of these items are brought into income as the gas is sold, and the option value included in other comprehensive income is moved into Net Income at that time.

8-14 Reason number five for entering into a derivative contract is to hedge for the benefit of ratepayers. If gains or losses on hedges are included in an adjustment mechanism such as a fuel adjustment clause or a purchase gas adjustment clause, then any market-to-market gain or loss for hedges would be offsite by a regulatory liability or regulatory asset.

8-15 Reason number six - A foreign currency hedge has complex rules as to when and where the income or loss is shown.

STATEMENT OF CASH FLOWS

9-1 The Statement of Cash Flows (page 70) is organized into three sections: Operating Activities, Investing Activities and Financing Activities. This organization explains all of the changes in cash and, at the same time, all of the changes in the other assets, liabilities and owners' equity.

a. How much is the net cash provided by Operating Activities (sometimes called Cash Flow)?

b. How much is the cash used in Investing Activities?

c. How much is the cash provided by Financing Activities?

9-2 The top part of the SCF gives us important information concerned with unraveling some of the accrual accounting figures shown on the Income Statement. The SCF almost always starts with an income figure and explains to us why this income is not cash. This is referred to as the indirect method. It tells us, in essence, how much more or less than this income the company generated in cash.

a. For CE what is the title on first item which has dollar amounts to the right of it?

b. What is the title of the last line of this reconciliation?

c. The items in between these two explain why the accrual accounting income is not equal to the cash from operations. How many items, in 2011, explain the difference on the CE statement?

9-3 The term Net Cash provided by operating activities is unfortunate since Operating has a different definition here than Income from Operations (or Operating Income) has on the Income Statement. On the SCF, Operations means all items on the Income Statement except for gains and losses on investing or financing activities that are in Net Income. How is Operating Income defined on the Income Statement and how does this differ from the use of the term Operating on the SCF?

9-4 In order to reconcile income with Cash from operating activities (which could usually be rephrased, but never is, Cash from Net Income Items), we must show certain items were subtracted out when we determined Net Income but did not use any cash. We show these items as "add backs" to income. Other items use more cash than the expense amount subtracted from income. These amounts need to be subtracted from income to get to cash flow. Explain why the two largest of the positive figures for "add back" items for CE do not use cash.

9-5 The tax expense on the Income Statement is not the amount of tax due soon or already paid for the year. What portion of the tax expense for CE has not been paid because of deferred income taxes?

9-6 Shown on the next page is the Tucson Electric Statement of Cash Flows. They use a direct approach in presenting the cash from operating activities. Instead of reconciling the cash from operating activities to the Net Income, the direct approach goes down the Income Statement and shows how much cash goes into and out of the bank from each income statement item.

Notice how direct approach is much simpler than the reconciliation approach. In either way of presenting this, the Cash from Operations figure shows us how much the company has earned in cash from its business activities. Had CE used the direct approach, what would the amount be for their Net cash provided by operating activities (Cash Flow)?

**TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Years Ended December 31, | | |
|--|--------------------------|------------------|------------------|
| | 2011 | 2010 | 2009 |
| - Thousands of Dollars - | | | |
| Cash Flows from Operating Activities | | | |
| Cash Receipts from Electric Retail Sales | \$ 963,247 | \$ 947,498 | \$ 944,873 |
| Cash Receipts from Electric Wholesale Sales | 152,618 | 190,779 | 199,918 |
| Cash Receipts from Operating Springerville Units 3 & 4 | 104,754 | 102,563 | 68,951 |
| Reimbursement of Affiliate Charges | 18,448 | 18,356 | 19,998 |
| Cash Receipts from Wholesale Gas Sales | 11,825 | — | — |
| Income Tax Refunds Received | 7,492 | 3,369 | 14,462 |
| Interest Received | 5,367 | 8,998 | 12,768 |
| Performance Deposits Received | 1,640 | 5,040 | 14,000 |
| Other Cash Receipts | 17,971 | 18,389 | 19,440 |
| Payment of Other Operations and Maintenance Costs | (283,560) | (245,050) | (233,075) |
| Fuel Costs Paid | (276,030) | (236,436) | (282,653) |
| Taxes Other Than Income Taxes Paid, Net of Amounts Capitalized | (139,728) | (134,540) | (124,053) |
| Purchased Power Costs Paid | (117,224) | (169,658) | (185,129) |
| Wages Paid, Net of Amounts Capitalized | (100,942) | (101,815) | (97,289) |
| Interest Paid, Net of Amounts Capitalized | (45,433) | (38,232) | (33,128) |
| Capital Lease Interest Paid | (32,103) | (38,640) | (38,586) |
| Wholesale Gas Costs Paid | (11,822) | — | — |
| Income Taxes Paid | (2,346) | (19,663) | (14,606) |
| Performance Deposits Paid | (1,640) | (5,040) | (14,000) |
| Other Cash Payments | (4,240) | (3,435) | (3,827) |
| Net Cash Flows - Operating Activities | 268,294 | 302,483 | 268,064 |
| Cash Flows from Investing Activities | | | |
| Capital Expenditures | (351,890) | (225,920) | (240,079) |
| Purchase of Intangibles - Renewable Energy Credits | (5,111) | (7,903) | — |
| Purchase of Sundt Unit 4 Lease Asset | — | (51,389) | — |
| Purchase of Springerville Lease Debt | — | — | (31,375) |
| Other Cash Payments | (558) | (1,483) | (411) |
| Return of Investments in Springerville Lease Debt | 38,353 | 25,615 | 12,736 |
| Other Cash Receipts | 7,195 | 8,044 | 9,528 |
| Net Cash Flows - Investing Activities | (312,011) | (253,036) | (249,601) |
| Cash Flows from Financing Activities | | | |
| Proceeds from Issuance of Long-Term Debt | 260,285 | 118,245 | — |
| Proceeds from Borrowings Under Revolving Credit Facility | 220,000 | 177,000 | 171,000 |
| Equity Investment from UniSource Energy | 30,000 | 15,000 | 30,000 |
| Other Cash Receipts | 2,458 | 3,241 | 2,447 |
| Repayments of Borrowings Under Revolving Credit Facility | (210,000) | (212,000) | (146,000) |
| Repayments of Long-Term Debt | (172,460) | (30,000) | — |
| Payments of Capital Lease Obligations | (74,343) | (55,889) | (24,091) |
| Payments of Debt Issue/Retirement Costs | (3,594) | (5,988) | (1,329) |
| Dividends Paid to UniSource Energy | — | (60,000) | (60,000) |
| Other Cash Payments | (894) | (1,491) | (1,347) |
| Net Cash Flows - Financing Activities | 51,452 | (51,882) | (29,320) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 7,735 | (2,435) | (10,857) |
| Cash and Cash Equivalents, Beginning of Year | 19,983 | 22,418 | 33,275 |
| Cash and Cash Equivalents, End of Year | \$ 27,718 | \$ 19,983 | \$ 22,418 |

9-7 Out of this cash flow, dividends are paid, plant is built, and debt is retired.

Look at the negative figures below CE's Cash Flow. How much cash did they pay out for construction expenditures?

9-8 The company gets extra cash it needs from issuing stock and bonds. What did CE do in this regard?

BEYOND THE BALANCE SHEET

10-1 The Balance Sheet shows us the Assets, Liabilities and Owners' Equity of the firm, as the accountant measures these items. These figures are not always what we might feel are the appropriate ones for a specific situation. Label each of the following as True or False:

- _____ a. Utility plant is shown at its replacement cost (i.e., what it would cost to replace the plant)
- _____ b. Common stockholders' equity is shown at the market value of the common stock
- _____ c. Long term debt is shown at the market value of this debt

10-2 Assets could be defined as economic resources which have benefit to the future. Applying this definition, which of the following would be assets:

- _____ a. utility plant owned
- _____ b. utility plant leased from others for its entire life
- _____ c. franchise territory
- _____ d. technical expertise of employees
- _____ e. effective operations staff

10-3 However, accountants do not consider all economic resources, which have to benefit to the future to be assets. When the item does not have a measurable, out of pocket cost, it is usually not an asset. Even when the cost is measurable, the asset might be fully amortized (depreciated) while its value has not diminished. Most assets are never shown at an amount higher than its cost. Why are the following items usually not shown as assets:

- a. franchise territory

- b. technical expertise of employees

- c. effective operations staff

10-4 Leased assets are a difficult problem since many leases are really financing arrangements and could better be considered a purchase of an asset and a loan. These leases are termed financing or capital leases. GAAP requires that capital leases be shown on the Balance Sheet as if the assets leased were owned by the company. Does CE have any capital leases? (see page 118)

10-5 Apparently, leased assets and the obligations to pay the rent, are not always shown on the Balance Sheet. Leases other than capital leases are termed operating leases. These leases are never shown on the Balance Sheet. Match the following by putting the appropriate letter next to the Roman numeral:

_____ I. Financing Lease a. asset appears on Balance Sheet

_____ II. Operating Lease b. asset and liability appears in Balance Sheet

_____ III. Purchase c. asset not on Balance Sheet

10-6 Does CE have any operating leases? (see page 118)

10-7 Explain why the term Off Balance Sheet Financing is appropriate for some leases.

10-8 Other economic obligations which might not show up as liabilities on a company's Balance Sheet include:

- I. Commitments-usually executory contracts (i.e., those not yet fully executed or carried out). Some examples are on page 117
- II. Contingencies- look at the item related to this on CE's Balance Sheet. Some examples are on pages 115-116
- III. Guarantees Some examples are on page 116

At what amount are these items shown on the Balance Sheet?

10-9 Concerning the commitments

- a. How much does CECONY have to pay in the next 5 years for capacity and energy under long term contracts? (see page 117)

10-10 A general rule for contracts which have not been carried out is to show the impact of the contract on the assets, liabilities and owners' equity of the firm only to the extent that one party to the contract or the other has carried out the contract. We might call this the executory contract rule. The rule allows us to see why certain obligations do not show up as liabilities. For example, the utility enters into an employment agreement with a new Chief Executive Officer (CEO). The company agrees to pay \$2,000,000 a year for five years and the CEO agrees to work for five years.

- a. When the contract is signed, to what extent has the company carried out the terms?
- b. When the contract is signed, to what extent has the CEO carried out the terms?
- c. At what amount will the obligations to pay the \$2,000,000 per year for five years be shown as a liability?

10-11 Which of the following types of contracts would not show up as liabilities due to the executory contract rule?

_____a. Agreement to pay a construction firm \$800,000,000 to build a facility. Work on the project is to begin next month.

_____b. Purchase order for \$100,000 of supplies to be delivered over the next two years.

_____c. Take or pay contract agreeing to purchase power at stated prices for the next five years and agreeing to accept a specific amount each year. (The "take or pay" should more descriptively be called "take and pay or don't take and pay" since any power below the "specific amount" not taken must be paid for anyway.)

_____d. Invoice to pay for \$200,000,000 of power just received.

_____e. Lease agreement which a company employee just signed to rent a Hertz car for two weeks at \$229 per week.

10-12 A lease fits the definition of an executory contract but some leases (i.e., those which are really a purchase and a loan) will violate the executory contract rule. Which category of leases (operating or capital) violate the executory contract rule and which follow the rule?

Violate _____

Follow _____

10-13 Derivatives and energy trading contracts, which are market to market, clearly violate the executory contract rule. (No answer required)

10-14 The executory contract rule also causes some assets to be missing from the Balance Sheet. For example, if a financing (capital) lease were to follow the executory contract rule, which asset would appear along with the lease liability?

10-15 Concerning the Contingencies. Under GAAP contingencies, events that may happen are not shown liabilities unless they are probable. On what page does CE start to discuss their many contingencies?

10-16 Many of the off balance sheet assets and liabilities are disclosed in the Notes if material in amount. The financial statement figures can be adjusted for these differences whenever you feel this is appropriate. These adjustments might change the financial ratios you are interested in. (No answer required)

ANSWERS

1-1

- a. 68
- b. 69-77
- c. 71-72
- d. 69
- e. 74
- f. 70

1-2

- a. Yes
- b. Yes, on a per share basis
- c. yes, but they have excluded some "special items"
- d. yes
- e. no
- f. no
- g. yes
- h. no
- i. yes

2-1 The end of the day on December 31, 2010 and 2011 (only the last two years are required - hence most companies only show 2 years)

2-2

- a. 10,143
- b. 213
- c. 11,436
- d. 21,792

2-3

a. 46.5%

b. 1.0%

c. 52.5%

(Remember: When your calculator has .4859 as the answer, this is 48.59% and when rounded is 48.6%)

2-4 Long-term debt

2-5 No answer required

2-6 39,214

2-7 39,214

2-8 Assets = Liabilities + Owners' Equity

2-9 Utility Plant

2-10 Property, Plant and Equipment

2-11 Current Assets

2-12 Capitalization or Common Shareholders' Equity

2-13 Current Assets

Utility Plant

Other Noncurrent Assets

2-14

a. 29,775

b. No

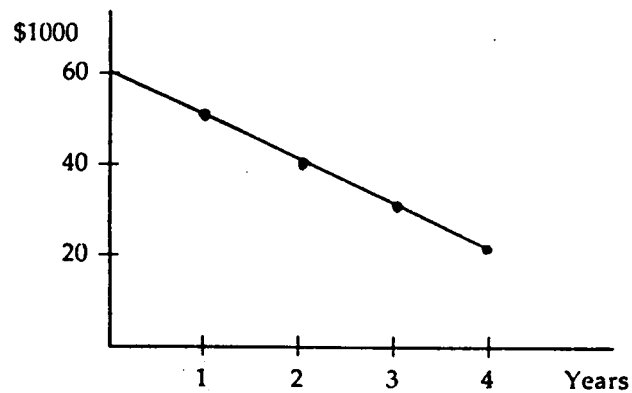
2-15 Accumulated depreciation

2-16

a.

| End of Year | 3 | 4 |
|--------------------------|--------|--------|
| Original Cost | 60,000 | 60,000 |
| Accumulated Depreciation | 30,000 | 40,000 |
| Net Book Value | 30,000 | 20,000 |

b.



c. Straight Line

d. Straight Line Depreciation

e. Plant and Depreciation

2-17. Plant is not depreciated until it is in service

2-18 No

2-19

a. Fuel and Accounts Receivable

b. They are shown at what they cost. (Except for non-regulated items which are at lower of cost or market.)

2-20 No, except for the term Deferred Credits on the liability side of the Balance Sheet.

2-21

a. $9,337 + 164 = 9,501$

b. 681

2-22

a. 4

b. 3

c. 2

d. 1

2-23 Long-term debt.due within one year

3-1 Statement of Financial Position

3-2 No answer required

3-3 5023 (32 + 4991)

3-4 Reinvested Earnings

3-5 Retained Earnings and Accumulated Other Comprehensive Income/(Loss)

3-6 There are more shares of stock.

3-7 No answer required

3-8 Statement of Common Shareholder's Equity

3-9 Net Income for common stock
Common Stock divide

3-11 NI

3-12 1,062

3-13

Consolidated Edison, Inc.

Consolidated Income Statement

| (Millions of Dollars/Except Share Data) | For the Years Ended December 31, | | |
|---|----------------------------------|----------|----------|
| | 2011 | 2010 | 2009 |
| OPERATING REVENUES | | | |
| Electric | + \$ 8,918 | \$ 9,064 | \$ 8,320 |
| Gas | + 1,735 | 1,760 | 1,943 |
| Steam | + 683 | 656 | 661 |
| Non-utility | + 1,602 | 1,845 | 2,108 |
| TOTAL OPERATING REVENUES | 12,938 | 13,325 | 13,032 |
| OPERATING EXPENSES | | | |
| Purchased power | - 3,967 | 4,613 | 4,776 |
| Fuel | - 412 | 458 | 503 |
| Gas purchased for resale | - 622 | 683 | 963 |
| Other operations and maintenance | - 2,969 | 2,888 | 2,555 |
| Depreciation and amortization | - 884 | 840 | 791 |
| Taxes, other than income taxes | - 1,845 | 1,723 | 1,545 |
| TOTAL OPERATING EXPENSES | 10,699 | 11,205 | 11,133 |
| OPERATING INCOME | 2,239 | 2,120 | 1,899 |
| OTHER INCOME (DEDUCTIONS) | | | |
| Investment and other income | + 23 | 46 | 32 |
| Allowance for equity funds used during construction | + 11 | 15 | 14 |
| Other deductions | - (17) | (21) | (15) |
| TOTAL OTHER INCOME (DEDUCTIONS) | 17 | 40 | 31 |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 2,256 | 2,160 | 1,930 |
| INTEREST EXPENSE | | | |
| Interest on long-term debt | - 582 | 597 | 590 |
| Other interest | - 18 | 21 | 30 |
| Allowance for borrowed funds used during construction | + (6) | (9) | (9) |
| NET INTEREST EXPENSE | 594 | 609 | 611 |
| INCOME BEFORE INCOME TAX EXPENSE | 1,662 | 1,551 | 1,319 |
| INCOME TAX EXPENSE | - 600 | 548 | 440 |
| NET INCOME | 1,062 | 1,003 | 879 |
| Preferred stock dividend requirements of subsidiary | - (11) | (11) | (11) |
| NET INCOME FOR COMMON STOCK | \$ 1,051 | \$ 992 | \$ 868 |

3-14 No answer required

3-15

Operating Revenues
Operating Expenses
Other Income
Interest Expense
Income Tax Expense

3-16 No, since expenses are not shown by segment. Page 126 contains information in this regard.

3-17

a. Yes

b. No

c. No

d. No

3-18 The next year

3-19 No, only how much revenue was earned in cash, accounts receivable and unbilled revenue.

3-20

a. Accounts Receivable –customers 1,123

b. 12,938

3-21 10,699

3-22 No

3-23 No, since an expense is a cost necessary to get revenue and the 1887 was not needed to get revenue in 2011..

3-24 $1/40$ if we assume it is used up evenly over the 40 years with 0 salvage value and 0 removal cost (or $1887/40=47.2$)

3-25 Straight line

3-26 Accrual

3-27

a. $884/1887=46.8\%$

b. No

3-28 c

3-29 No, it gives us the cost of plant added. The utility may have added more or less plant capacity than the amount used up.

3-30 d

3-31

a. Net Income and Net Income for Common Stock

b. $1051/292.6=3.59$

Yes.

4-1

a. No

b. No

c. No

d. No

4-2

a. Income Statement

b. 3

4-3 Balance Sheet

4-4

a. $(11,061 + 11,436)/2 = 11,248$

b. $1051 / 11,248 = 9.34\%$

4-5 $2.40/49.57 + (62.03 - 49.57)/49.57 = 4.84\% + 25.14\% = 29.98\%$

4-6 No

4-7

a. Accrual

b. Dividends

4-8 $2.40/3.59 = 66.9\%$

4-9 Stock price appreciation (or stock price decline if a negative return).

4-10 $11,436/291.616 = 39.22$

4-11 No answer required

4-12

| | |
|---|------|
| Income before Interest and Income Taxes | 2256 |
| Divided by Interest Expense | 600 |
| = Times Interest Earned | 3.76 |

4-13 $62.03/3.57=17.4$

4-14 A different point in time

4-15 AT&T- It has the highest expected growth in earnings.

4-16 Future growth of earnings, and therefore dividends and/or stock price growth is expected to be greater than the regulated utility.

4-17

a. 10,699

b. Companies vary in size.

c. $10,699/12,938=82.7\%$

5-1 The accompanying notes are an integral part of these financial statements

5-2

| | | | |
|----|-----|----|---|
| A. | 1,3 | H. | 4 |
| B. | 3,4 | I. | 4 |
| C. | 3,4 | J. | 4 |
| D. | 3 | K. | 3 |
| E. | 2 | L. | 3 |
| F. | 2 | | |
| G. | 3,4 | | |

5-3 a,c

5-4

1. Impairments
2. Plant and Depreciation – Utility Plant
3. Federal Income Tax
4. Plant and Depreciation – Utility Plant
5. Accounting Policies

5-5 CECONY and O&R

5-6

- a. c
- b. e
- c. c

5-7 “indirect costs such as engineering supervision, payroll taxes, pensions other benefits and ... AFDC.” Page 88

5-8 Construction Works in Progress (CWIP)

5-9

- a. These costs will be collected from ratepayers in the future
- b. These costs will be collected from ratepayers in the future – an regulatory asset of 14 or returned to the ratepayers – a regulatory liability of 51.

5-10 Depreciation

5-11 No answer required

5-12 Pretax Income. This would allow the company to pay tax on lower profits than it shows to the regulators and financial statement users.

5-13 Expanded disclosure requirements in Fair Value Measurements in order to make the wording of US GAAP more like IFRS (International Financial Reporting Standards) the GAAP used by most countries .

5-14 No, the tax rules are made by Congress not the FASB.

5-15 New York State Public Service Commission

5-16 No

5-17 Regulatory Assets and Liabilities

5-18 a, d, e

5-19

I. b

II. c

III. a

IV. d

6-1 b, c, d

6-2

a. True

b. True

c. True

6-3 Accrual accounting

6-4 Accrual accounting

6-5 No, only cash can be used to pay for construction.

6-6 AFUDC – Debt 6 AFUDC - Equity 11

6-7 $269,667/476,734 = 56.6\%$

6-8

- a. First, CWIP must be put into service, i.e., become utility plant in service.
- b. Second, the regulators must allow the cost of the plant (formally CWIP) to be collected from the ratepayers through depreciation.

6-9 No answer required.

6-10 Those with little or no AFUDC.

6-11 Yes, since the ratio is intended to show the degree of safety in paying, with cash, the interest. The AFUDC is not cash and may be misleading if included in the Net Income.

6-12 6.9%

6-13 No, since it has some AFUDC.

7-1 No

7-2

- a. \$1,000,000
- b. \$1,000,000
- c. The cost of the assets is being spread (allocated) over a period of time. The total amount will be the same since each method of accounting is based on spreading the same cost.
- d. The timing of the expense is different although the total is the same. The \$1,000,000 shows up in different amounts in different years.
- e. Higher deductions in earlier years reduces taxes.
- f. In later years, less deductions (0 in years 7 through 10) are allowed on the tax return and hence higher taxes will be paid than if straight line depreciation had been used.

7-3

| Income Statement | | Tax Return | |
|-------------------|-------|----------------|-------|
| Rental Revenue | 250 | Rental Revenue | 250 |
| Depreciation Exp. | 100 | Depr. Exp. | 200 |
| | _____ | | _____ |
| Pretax Income | 150 | Taxable Income | 50 |
| Tax Expense | 52.5 | Tax Due | 17.5 |
| | _____ | | |
| Net Income | 97.5 | | |

The term Taxable Income is only appropriate when speaking of the number on the Tax Return. Pretax Income or Income before Tax is the term used on the Income Statement. Tax Expense is not a term ever seen on the Tax Return. It is on the Income Statement. It is important to use different terms for these items since, as shown in the answer above, the amounts are different on the Financial Statements (Income Statement) than on the Tax Return.

7-4 Rates would be reduced to flow through the benefits of the tax break to the rate payers. The utility will not be better off using accelerated depreciation since it will not get any of this reduced tax.

7-5

a. $17.5/150 = 11.7\%$

b. $35\% \text{ of } 150 = 52.5$

c. I. B

II. A

d. Accrual accounting is defined as showing the revenue where it is earned and the expenses matched with the revenue regardless of the cash receipts or payments. Tax expense, when normalization is used, is an accrual accounting figure. It is the amount which "belongs" with the revenue and expenses shown on the Income Statement, not the amount of cash tax paid or to be paid soon.

7-6 35

7-7 Deferred income taxes

7-8 No, since they would be paying more than would be shown as appropriate on the Income Statement.

7-9 600

7-10 No. This is an accrual accounting figure and does not represent payments of cash. We know some of this tax expense may be deferred.

7-11 $56 + 63 = 119$

7-12 The first one.

7-13 Income Tax Expense (Total)

7-14 Depreciation
Regulatory Asset – future income tax
Unrecognized Pension...

7-15 No, the deferred tax liability due to these three items are going up from 2010 to 2011

7-16 Deferred tax Liability and Income Tax Expense

7-17 $3,699 - 3,083 = 616$ higher

7-18

a. Flow through

b. State income tax

7-19

a. No

b. 3,000,000

c. $3,000,000/30 = 100,000$

d. 30

e. 2,900,000

7-21 Yes, they are due to events in that year and we are sure the refund is forthcoming.

7-22 No answer required

8-1 Fair value of derivative assets
Fair value of derivative liabilities

8-2 To hedge market price fluctuations of purchases

8-3 Yes

8-4 No answer required

8-5

a. $\$60 - \$50 = \$10$
 $\$10 \times 10,000 = \$100,000$ value

b. \$100,000

c. 70

8-6 greater by \$100,000

8-7

a. $\$50 - \$35 = \$15 \times 10,000 = \$150,000$

b. \$150,000

8-8

a. No, these would be 'normal purchase' contracts

b. They were buying this capacity and energy in their ordinary course of business expecting to deliver this power to their customers.

8-9 No answer required

8-10 A forward sales contract to sell in March 2008
10,000 MWH at \$50/MWH

8-11 No answer required

8-12 0

8-13 No answer required

8-14 No answer required

8-15 No answer required

9-1

a. 3,137

b. (2,150)

c. (677)

9-2

a. Net Income

b. Net Cash Flows From Operating Activities

c. 18

9-3 Operation Income on the Income Statement refers to earnings from the main business activities of the company before financing costs and before income tax. Cash from operating activities on the SCF refers to all revenue and expenses providing or using cash except for gains or losses on financing or investing activities. Hence, operations on the Income Statement excludes items such as other income, interest expense, and income taxes while the SCF would consider these items as providing or using cash from operations.

9-4 Depreciation does not use any cash. Depreciation is the using up of a plant. The cash for plant was spent years ago when the plant was built, not this year. Some of the income tax expense was not paid in cash but was deferred instead.

9-5 491

9-6 3,137

9-7 1,887

9-8 Issued common stock for 118

10-1

- a. False; shown at historical cost less accumulated depreciation.
- b. False; shown at the amount invested or left in business by common shareholders.
- c. False.

10-2 all the answers (a-e)

10-3

- a. The franchise territory is not shown as an asset because there is typically no out of pocket cost.
- b. Technical expertise of employees is not an out of pocket cost.
- c. Effective operations staff is not an out of pocket cost.

10-4 Yes with assets of 9 shown on the Balance Sheet

10-5 I. b

II. c

III. a

10-6 Yes, with 263 of future obligation

10-7 Operating lease obligations do not show up as a liability.

10-8 Zero

10-9 $492 + 491 + 433 + 221 + 158 = 1795$

10-10

a. Terms not carried out; only an agreement to do so.

b. Same as (a) above.

c. Zero

10-11 a, b, c & e

10-12

Violate: Capital leases

Follow: Operating leases

10-13 No answer required

10-14 The asset leased as utility plant.

10-15 Page 114 Note G

10-16 No answer required.

**United States
Securities And Exchange Commission
Washington, D.C. 20549**

FORM 10-K

Annual Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For The Fiscal Year Ended December 31, 2011

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 1-14514

CONSOLIDATED EDISON, INC.

Exact name of registrant as specified in its charter
and principal office address and telephone number

New York
(State of Incorporation)

13-3965100
I.R.S. Employer
ID. Number

4 Irving Place,
New York, New York 10003

(212) 460-4600

Commission File Number 1-1217

CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.

Exact name of registrant as specified in its charter
and principal office address and telephone number

New York
(State of Incorporation)

13-5009340
I.R.S. Employer
ID. Number

4 Irving Place,
New York, New York 10003

(212) 460-4600

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|--|--|
| Consolidated Edison, Inc., Common Shares (\$.10 par value) | New York Stock Exchange |
| Consolidated Edison Company of New York, Inc., \$5 Cumulative Preferred Stock, without par value | New York Stock Exchange |
| Cumulative Preferred Stock, 4.65% Series C (\$100 par value) | New York Stock Exchange |

Securities Registered Pursuant to Section 12(g) of the Act:

| Title of each class |
|--|
| Consolidated Edison Company of New York, Inc. Cumulative Preferred Stock, 4.65% Series D (\$100 par value) |

Glossary of Terms

The following is a glossary of frequently used abbreviations or acronyms that are used in the Companies' SEC reports:

Con Edison Companies

| | |
|-------------------------------|---|
| Con Edison | Consolidated Edison, Inc. |
| CECONY | Consolidated Edison Company of New York, Inc. |
| Con Edison Development | Consolidated Edison Development, Inc. |
| Con Edison Energy | Consolidated Edison Energy, Inc. |
| Con Edison Solutions | Consolidated Edison Solutions, Inc. |
| O&R | Orange and Rockland Utilities, Inc. |
| Pike | Pike County Light & Power Company |
| RECO | Rockland Electric Company |
| The Companies | Con Edison and CECONY |
| The Utilities | CECONY and O&R |

Regulatory Agencies, Government Agencies, and Quasi-governmental Not-for-Profits

| | |
|----------------|--|
| EPA | U.S. Environmental Protection Agency |
| FERC | Federal Energy Regulatory Commission |
| IRS | Internal Revenue Service |
| ISO-NE | ISO New England Inc. |
| NJBPU | New Jersey Board of Public Utilities |
| NJDEP | New Jersey Department of Environmental Protection |
| NYISO | New York Independent System Operator |
| NYPA | New York Power Authority |
| NYSAG | New York State Attorney General |
| NYSDEC | New York State Department of Environmental Conservation |
| NYSERDA | New York State Energy Research and Development Authority |
| NYSPSC | New York State Public Service Commission |
| NYSRC | New York State Reliability Council, LLC |
| PAPUC | Pennsylvania Public Utility Commission |
| PJM | PJM Interconnection LLC |
| SEC | U.S. Securities and Exchange Commission |

Accounting

| | |
|-------------|---|
| ABO | Accumulated Benefit Obligation |
| ASU | Accounting Standards Update |
| FASB | Financial Accounting Standards Board |
| LILO | Lease In/Lease Out |
| OCI | Other Comprehensive Income |
| SFAS | Statement of Financial Accounting Standards |
| VIE | Variable interest entity |

Environmental

| | |
|-----------------------|---|
| CO₂ | Carbon dioxide |
| GHG | Greenhouse gases |
| MGP Sites | Manufactured gas plant sites |
| PCBs | Polychlorinated biphenyls |
| PRP | Potentially responsible party |
| SO₂ | Sulfur dioxide |
| Superfund | Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state statutes |

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of Consolidated Edison, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Consolidated Edison, Inc. and its subsidiaries (the Company) at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates

made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
New York, New York
February 21, 2012

Consolidated Edison, Inc.
Consolidated Income Statement

| (Millions of Dollars/Except Share Data) | For the Years Ended December 31, | | |
|---|----------------------------------|----------------|----------------|
| | 2011 | 2010 | 2009 |
| OPERATING REVENUES | | | |
| Electric | \$ 8,918 | \$ 9,064 | \$ 8,320 |
| Gas | 1,735 | 1,760 | 1,943 |
| Steam | 683 | 656 | 661 |
| Non-utility | 1,602 | 1,845 | 2,108 |
| TOTAL OPERATING REVENUES | 12,938 | 13,325 | 13,032 |
| OPERATING EXPENSES | | | |
| Purchased power | 3,967 | 4,613 | 4,776 |
| Fuel | 412 | 458 | 503 |
| Gas purchased for resale | 622 | 683 | 963 |
| Other operations and maintenance | 2,969 | 2,888 | 2,555 |
| Depreciation and amortization | 884 | 840 | 791 |
| Taxes, other than income taxes | 1,845 | 1,723 | 1,545 |
| TOTAL OPERATING EXPENSES | 10,699 | 11,205 | 11,133 |
| OPERATING INCOME | 2,239 | 2,120 | 1,899 |
| OTHER INCOME (DEDUCTIONS) | | | |
| Investment and other income | 23 | 46 | 32 |
| Allowance for equity funds used during construction | 11 | 15 | 14 |
| Other deductions | (17) | (21) | (15) |
| TOTAL OTHER INCOME (DEDUCTIONS) | 17 | 40 | 31 |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 2,256 | 2,160 | 1,930 |
| INTEREST EXPENSE | | | |
| Interest on long-term debt | 582 | 597 | 590 |
| Other interest | 18 | 21 | 30 |
| Allowance for borrowed funds used during construction | (6) | (9) | (9) |
| NET INTEREST EXPENSE | 594 | 609 | 611 |
| INCOME BEFORE INCOME TAX EXPENSE | 1,662 | 1,551 | 1,319 |
| INCOME TAX EXPENSE | 600 | 548 | 440 |
| NET INCOME | 1,062 | 1,003 | 879 |
| Preferred stock dividend requirements of subsidiary | (11) | (11) | (11) |
| NET INCOME FOR COMMON STOCK | \$ 1,051 | \$ 992 | \$ 868 |
| Net income for common stock per common share — basic | \$ 3.59 | \$ 3.49 | \$ 3.16 |
| Net income for common stock per common share — diluted | \$ 3.57 | \$ 3.47 | \$ 3.14 |
| DIVIDENDS DECLARED PER SHARE OF COMMON STOCK | \$ 2.40 | \$ 2.38 | \$ 2.36 |
| AVERAGE NUMBER OF SHARES OUTSTANDING — BASIC (IN MILLIONS) | 292.6 | 284.3 | 275.2 |
| AVERAGE NUMBER OF SHARES OUTSTANDING — DILUTED (IN MILLIONS) | 294.4 | 285.9 | 276.3 |

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

Consolidated Edison, Inc.
Consolidated Statement of Cash Flows
For the Twelve Months Ended December 31,

| (Millions of Dollars) | 2011 | 2010 | 2009 |
|---|----------------|----------------|----------------|
| OPERATING ACTIVITIES | | | |
| Net Income | \$ 1,062 | \$ 1,003 | \$ 879 |
| PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME | | | |
| Depreciation and amortization | 884 | 840 | 791 |
| Deferred income taxes | 491 | 659 | 436 |
| Rate case amortization and accruals | 49 | 13 | (63) |
| Common equity component of allowance for funds used during construction | (11) | (15) | (14) |
| Net derivative (gains)/losses | 22 | (19) | (31) |
| Other non-cash items (net) | 144 | (18) | (77) |
| CHANGES IN ASSETS AND LIABILITIES | | | |
| Accounts receivable – customers, less allowance for uncollectibles | 50 | (126) | 51 |
| Materials and supplies, including fuel oil and gas in storage | (8) | 7 | 161 |
| Other receivables and other current assets | 51 | 207 | (346) |
| Prepayments | 196 | (210) | 566 |
| Recoverable energy costs | - | - | 90 |
| Accounts payable | (195) | (22) | (18) |
| Pensions and retiree benefits | 151 | 78 | (14) |
| Superfund and environmental remediation costs (net) | (9) | (3) | (48) |
| Accrued taxes | 98 | 38 | (6) |
| Accrued interest | 5 | (1) | 17 |
| Deferred charges, noncurrent assets and other regulatory assets | (139) | (287) | 122 |
| Deferred credits and other regulatory liabilities | 234 | 80 | (23) |
| Other assets | - | (9) | (5) |
| Other liabilities | 62 | 166 | (2) |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 3,137 | 2,381 | 2,466 |
| INVESTING ACTIVITIES | | | |
| Utility construction expenditures | (1,887) | (1,986) | (2,170) |
| Cost of removal less salvage | (167) | (149) | (181) |
| Non-utility construction expenditures | (80) | (28) | (9) |
| Proceeds from investment tax credits and grants related to renewable energy investments | 4 | - | - |
| Net investment in Pilesgrove solar project | (20) | - | - |
| Purchase of additional ownership interest in Honeoye Storage Corporation | - | (12) | - |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (2,150) | (2,175) | (2,360) |
| FINANCING ACTIVITIES | | | |
| Net payments of short-term debt | - | - | (363) |
| Issuance of long-term debt | - | 1,095 | 1,470 |
| Retirement of long-term debt | (4) | (1,011) | (662) |
| Issuance of common stock | 118 | 439 | 257 |
| Repurchase of common stock | (87) | - | - |
| Debt issuance costs | - | (11) | (10) |
| Common stock dividends | (693) | (629) | (601) |
| Preferred stock dividends | (11) | (11) | (11) |
| NET CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES | (677) | (128) | 80 |
| CASH AND TEMPORARY CASH INVESTMENTS: | | | |
| NET CHANGE FOR THE PERIOD | 310 | 78 | 186 |
| BALANCE AT BEGINNING OF PERIOD | 338 | 260 | 74 |
| BALANCE AT END OF PERIOD | \$ 648 | \$ 338 | \$ 260 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid/(refunded) during the period for: | | | |
| Interest | \$ 563 | \$ 583 | \$ 558 |
| Income taxes | \$ (236) | \$ (25) | \$ 5 |

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

Consolidated Edison, Inc.
Consolidated Balance Sheet

| (Millions of Dollars) | December 31, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and temporary cash investments | \$ 648 | \$ 338 |
| Accounts receivable — customers, less allowance for uncollectible accounts of \$87 and \$76 in 2011 and 2010, respectively | 1,123 | 1,173 |
| Accrued unbilled revenue | 474 | 633 |
| Other receivables, less allowance for uncollectible accounts of \$10 and \$8 in 2011 and 2010, respectively | 303 | 293 |
| Fuel oil, gas in storage, materials and supplies, at average cost | 356 | 348 |
| Prepayments | 145 | 341 |
| Deferred tax assets — current | 266 | 162 |
| Regulatory assets | 164 | 203 |
| Other current assets | 159 | 178 |
| TOTAL CURRENT ASSETS | 3,638 | 3,669 |
| INVESTMENTS | 455 | 403 |
| UTILITY PLANT, AT ORIGINAL COST | | |
| Electric | 21,105 | 19,851 |
| Gas | 4,727 | 4,344 |
| Steam | 1,983 | 2,038 |
| General | 1,960 | 1,911 |
| TOTAL | 29,775 | 28,144 |
| Less: Accumulated depreciation | 6,051 | 5,808 |
| Net | 23,724 | 22,336 |
| Construction work in progress | 1,241 | 1,458 |
| NET UTILITY PLANT | 24,965 | 23,794 |
| NON-UTILITY PLANT | | |
| Non-utility property, less accumulated depreciation of \$59 and \$51 in 2011 and 2010, respectively | 89 | 46 |
| Construction work in progress | 39 | 23 |
| NET PLANT | 25,093 | 23,863 |
| OTHER NONCURRENT ASSETS | | |
| Goodwill | 429 | 429 |
| Intangible assets, less accumulated amortization of \$3 in 2011 and 2010 | 3 | 3 |
| Regulatory assets | 9,337 | 7,683 |
| Other deferred charges and noncurrent assets | 259 | 298 |
| TOTAL OTHER NONCURRENT ASSETS | 10,028 | 8,413 |
| TOTAL ASSETS | \$39,214 | \$36,348 |

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

Consolidated Edison, Inc.
Consolidated Balance Sheet

| (Millions of Dollars) | December 31, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Long-term debt due within one year | \$ 530 | \$ 5 |
| Accounts payable | 961 | 1,151 |
| Customer deposits | 303 | 289 |
| Accrued taxes | 188 | 90 |
| Accrued interest | 160 | 155 |
| Accrued wages | 90 | 102 |
| Fair value of derivative liabilities | 169 | 125 |
| Regulatory liabilities | 118 | 159 |
| Other current liabilities | 468 | 454 |
| TOTAL CURRENT LIABILITIES | 2,987 | 2,530 |
| NONCURRENT LIABILITIES | | |
| Obligations under capital leases | 2 | 7 |
| Provision for injuries and damages | 181 | 165 |
| Pensions and retiree benefits | 4,835 | 3,287 |
| Superfund and other environmental costs | 489 | 512 |
| Asset retirement obligations | 145 | 109 |
| Fair value of derivative liabilities | 48 | 77 |
| Other noncurrent liabilities | 131 | 113 |
| TOTAL NONCURRENT LIABILITIES | 5,831 | 4,270 |
| DEFERRED CREDITS AND REGULATORY LIABILITIES | | |
| Deferred income taxes and investment tax credits | 7,563 | 6,769 |
| Regulatory liabilities | 977 | 788 |
| Other deferred credits | 64 | 46 |
| TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES | 8,604 | 7,603 |
| LONG-TERM DEBT (See Statement of Capitalization) | 10,143 | 10,671 |
| SHAREHOLDERS' EQUITY | | |
| Common shareholders' equity (See Statement of Common Shareholders' Equity) | 11,436 | 11,061 |
| Preferred stock of subsidiary (See Statement of Capitalization) | 213 | 213 |
| TOTAL SHAREHOLDERS' EQUITY | 11,649 | 11,274 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$39,214 | \$36,348 |

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

Consolidated Edison, Inc.**Consolidated Statement of Comprehensive Income**

| | For the Years Ended December 31, | | |
|--|---|-------------|-------------|
| (Millions of Dollars) | 2011 | 2010 | 2009 |
| NET INCOME | \$1,062 | \$1,003 | \$879 |
| OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | | | |
| Pension plan liability adjustments, net of \$(12), \$5 and \$17 taxes in 2011, 2010 and 2009, respectively | (18) | 2 | 26 |
| Less: Reclassification adjustment for (gains)/losses included in net income, net of \$1 taxes in 2009 | - | - | 1 |
| TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | (18) | 2 | 25 |
| COMPREHENSIVE INCOME | 1,044 | 1,005 | 904 |
| Preferred stock dividend requirements of subsidiary | (11) | (11) | (11) |
| COMPREHENSIVE INCOME FOR COMMON STOCK | \$1,033 | \$ 994 | \$893 |

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

Consolidated Edison, Inc.
Consolidated Statement of Common Shareholders' Equity

| (Millions of Dollars/Except Share Data) | Common Stock | | Additional Paid- In Capital | Retained Earnings | Treasury Stock | | Capital Stock Expense | Accumulated Other Comprehensive Income/(Loss) | Total |
|--|--------------|--------|-----------------------------------|----------------------|----------------|-----------|-----------------------------|--|----------|
| | Shares | Amount | | | Shares | Amount | | | |
| BALANCE AS OF | | | | | | | | | |
| DECEMBER 31, 2008 | 273,721,686 | \$29 | \$4,112 | \$6,685 | 23,210,700 | \$(1,001) | \$(60) | \$(67) | \$ 9,698 |
| Net income for common stock | | | | 868 | | | | | 868 |
| Common stock dividends | | | | (649) | | | | | (649) |
| Issuance of common shares – public offering | 5,000,000 | 1 | 214 | | | | (2) | | 213 |
| Issuance of common shares – dividend reinvestment and employee stock plans | 2,402,055 | | 94 | | | | | | 94 |
| Other comprehensive income | | | | | | | | 25 | 25 |
| BALANCE AS OF | | | | | | | | | |
| DECEMBER 31, 2009 | 281,123,741 | \$30 | \$4,420 | \$6,904 | 23,210,700 | \$(1,001) | \$(62) | \$(42) | \$10,249 |
| Net income for common stock | | | | 992 | | | | | 992 |
| Common stock dividends | | | | (676) | | | | | (676) |
| Issuance of common shares – public offering | 6,300,000 | 1 | 307 | | | | (2) | | 306 |
| Issuance of common shares – dividend reinvestment and employee stock plans | 4,192,593 | | 188 | | | | | | 188 |
| Other comprehensive income | | | | | | | | 2 | 2 |
| BALANCE AS OF | | | | | | | | | |
| DECEMBER 31, 2010 | 291,616,334 | \$31 | \$4,915 | \$7,220 | 23,210,700 | \$(1,001) | \$(64) | \$(40) | \$11,061 |
| Net income for common stock | | | | 1,051 | | | | | 1,051 |
| Common stock dividends | | | | (703) | | | | | (703) |
| Issuance of common shares – dividend reinvestment and employee stock plans | 1,272,187 | 1 | 76 | | (1,538,166) | 55 | | | 132 |
| Common stock repurchases | | | | | 1,521,541 | (87) | | | (87) |
| Other comprehensive income | | | | | | | | (18) | (18) |
| BALANCE AS OF | | | | | | | | | |
| DECEMBER 31, 2011 | 292,888,521 | \$32 | \$4,991 | \$7,568 | 23,194,075 | \$(1,033) | \$(64) | \$(58) | \$11,436 |

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

Consolidated Edison, Inc.**Consolidated Statement of Capitalization**

| (Millions of Dollars) | Shares outstanding | | At December 31, | |
|---|--------------------|--------------|-----------------|----------|
| | December 31, | December 31, | 2011 | 2010 |
| | 2011 | 2010 | 2011 | 2010 |
| TOTAL COMMON SHAREHOLDERS' EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS | 292,888,521 | 291,616,334 | \$11,494 | \$11,101 |
| Pension plan liability adjustments, net of \$(34) and \$(22) taxes in 2011 and 2010, respectively | | | (55) | (37) |
| Unrealized gains/(losses) on derivatives qualified as cash flow hedges, less reclassification adjustment for gains/(losses) included in net income and reclassification adjustment for unrealized losses included in regulatory assets, net of \$(2) taxes in 2011 and 2010 | | | (3) | (3) |
| TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAXES | | | (58) | (40) |
| TOTAL COMMON SHAREHOLDERS' EQUITY (SEE STATEMENT OF COMMON SHAREHOLDERS' EQUITY) | | | 11,436 | 11,061 |
| PREFERRED STOCK OF SUBSIDIARY | | | | |
| \$5 Cumulative Preferred, without par value, authorized 1,915,319 shares | 1,915,319 | 1,915,319 | 175 | 175 |
| Cumulative Preferred, \$100 par value, authorized 6,000,000 shares | | | | |
| 4.65% Series C | 153,296 | 153,296 | 16 | 16 |
| 4.65% Series D | 222,330 | 222,330 | 22 | 22 |
| TOTAL PREFERRED STOCK | | | \$ 213 | \$ 213 |

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

Consolidated Edison, Inc.
Consolidated Statement of Capitalization

| LONG-TERM DEBT (Millions of Dollars) | | | At December 31, | |
|--------------------------------------|---------------|--------|-----------------|--------|
| Maturity | Interest Rate | Series | 2011 | 2010 |
| DEBENTURES: | | | | |
| 2012 | 5.625% | 2002A | \$ 300 | \$ 300 |
| 2013 | 4.875 | 2002B | 500 | 500 |
| 2013 | 3.85 | 2003B | 200 | 200 |
| 2014 | 4.70 | 2004A | 200 | 200 |
| 2014 | 5.55 | 2009A | 275 | 275 |
| 2015 | 5.30 | 2005A | 40 | 40 |
| 2015 | 5.375 | 2005C | 350 | 350 |
| 2015 | 2.50 | 2010A | 55 | 55 |
| 2016 | 5.45 | 2006A | 75 | 75 |
| 2016 | 5.50 | 2006C | 400 | 400 |
| 2016 | 5.30 | 2006D | 250 | 250 |
| 2018 | 5.85 | 2008A | 600 | 600 |
| 2018 | 6.15 | 2008A | 50 | 50 |
| 2018 | 7.125 | 2008C | 600 | 600 |
| 2019 | 4.96 | 2009A | 60 | 60 |
| 2019 | 6.65 | 2009B | 475 | 475 |
| 2020 | 4.45 | 2010A | 350 | 350 |
| 2027 | 6.50 | 1997F | 80 | 80 |
| 2033 | 5.875 | 2003A | 175 | 175 |
| 2033 | 5.10 | 2003C | 200 | 200 |
| 2034 | 5.70 | 2004B | 200 | 200 |
| 2035 | 5.30 | 2005A | 350 | 350 |
| 2035 | 5.25 | 2005B | 125 | 125 |
| 2036 | 5.85 | 2006A | 400 | 400 |
| 2036 | 6.20 | 2006B | 400 | 400 |
| 2036 | 5.70 | 2006E | 250 | 250 |
| 2037 | 6.30 | 2007A | 525 | 525 |
| 2038 | 6.75 | 2008B | 600 | 600 |
| 2039 | 6.00 | 2009B | 60 | 60 |
| 2039 | 5.50 | 2009C | 600 | 600 |
| 2040 | 5.70 | 2010B | 350 | 350 |
| 2040 | 5.50 | 2010B | 115 | 115 |
| TOTAL DEBENTURES | | | 9,210 | 9,210 |
| TRANSITION BONDS: | | | | |
| 2019* | 5.22% | 2004-1 | 29 | 32 |
| TOTAL TRANSITION BONDS | | | 29 | 32 |

Consolidated Edison, Inc.**Consolidated Statement of Capitalization**

| LONG-TERM DEBT (Millions of Dollars) | | | At December 31, | |
|--|----------------------|----------------|------------------------|-------------|
| Maturity | Interest Rate | Series | 2011 | 2010 |
| TAX-EXEMPT DEBT - Notes issued to New York State Energy Research and Development Authority for Facilities Revenue Bonds**: | | | | |
| 2015 | 0.20% | 1995*** | 44 | 44 |
| 2032 | 0.193 | 2004B Series 1 | 127 | 127 |
| 2034 | 0.139 | 1999A | 293 | 293 |
| 2035 | 0.193 | 2004B Series 2 | 20 | 20 |
| 2036 | 0.222 | 2001B | 98 | 98 |
| 2036 | 1.45 | 2010A**** | 225 | 225 |
| 2039 | 0.21 | 2004A | 98 | 98 |
| 2039 | 0.08 | 2004C | 99 | 99 |
| 2039 | 0.067 | 2005A | 126 | 126 |
| TOTAL TAX-EXEMPT DEBT | | | 1,130 | 1,130 |
| Other long-term debt | | | 321 | 323 |
| Unamortized debt discount | | | (17) | (19) |
| TOTAL | | | 10,673 | 10,676 |
| Less: long-term debt due within one year | | | 530 | 5 |
| TOTAL LONG-TERM DEBT | | | 10,143 | 10,671 |
| TOTAL CAPITALIZATION | | | \$21,792 | \$21,945 |

* The final date to pay the entire remaining unpaid principal balance, if any, of all outstanding bonds is May 17, 2021.

** Other than Series 2010A, rates reset weekly or by auction held every 35 days; December 30, 2011 rates shown.

*** Issued for O&R pollution control financing.

**** Subject to mandatory tender in 2012.

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

Report of Management on Internal Control Over Financial Reporting

Management of Consolidated Edison Company of New York, Inc. and its subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of the effectiveness of controls to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Management of the Company assessed the effectiveness of internal control over financial reporting as of December 31, 2011, using the criteria established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on that assessment, management has concluded that the Company had effective internal control over financial reporting as of December 31, 2011.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2011, has been audited by PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, as stated in their report which appears on the following page of this Annual Report on Form 10-K.

Kevin Burke
Chairman and Chief
Executive Officer

Robert Hogle
Senior Vice President and
Chief Financial Officer

February 21, 2012

Report of Independent Registered Public Accounting Firm

To the Stockholder and Board of Trustees of Consolidated Edison Company of New York, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Consolidated Edison Company of New York, Inc. and its subsidiaries (the Company) at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and

significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
New York, New York
February 21, 2012

Consolidated Edison Company of New York, Inc.
Consolidated Income Statement

| (Millions of Dollars) | For the Years Ended December 31, | | |
|---|----------------------------------|----------|----------|
| | 2011 | 2010 | 2009 |
| OPERATING REVENUES | | | |
| Electric | \$ 8,280 | \$ 8,376 | \$ 7,674 |
| Gas | 1,521 | 1,541 | 1,701 |
| Steam | 683 | 656 | 661 |
| TOTAL OPERATING REVENUES | 10,484 | 10,573 | 10,036 |
| OPERATING EXPENSES | | | |
| Purchased power | 2,313 | 2,683 | 2,583 |
| Fuel | 412 | 458 | 503 |
| Gas purchased for resale | 518 | 574 | 818 |
| Other operations and maintenance | 2,561 | 2,493 | 2,186 |
| Depreciation and amortization | 829 | 787 | 744 |
| Taxes, other than income taxes | 1,768 | 1,656 | 1,486 |
| TOTAL OPERATING EXPENSES | 8,401 | 8,651 | 8,320 |
| OPERATING INCOME | 2,083 | 1,922 | 1,716 |
| OTHER INCOME (DEDUCTIONS) | | | |
| Investment and other income | 4 | 32 | 34 |
| Allowance for equity funds used during construction | 8 | 13 | 12 |
| Other deductions | (14) | (19) | (13) |
| TOTAL OTHER INCOME (DEDUCTIONS) | (2) | 26 | 33 |
| INCOME BEFORE INTEREST AND INCOME TAX EXPENSE | 2,081 | 1,948 | 1,749 |
| INTEREST EXPENSE | | | |
| Interest on long-term debt | 523 | 537 | 534 |
| Other interest | 16 | 19 | 27 |
| Allowance for borrowed funds used during construction | (5) | (7) | (8) |
| NET INTEREST EXPENSE | 534 | 549 | 553 |
| INCOME FROM CONTINUING OPERATIONS BEFORE TAXES | 1,547 | 1,399 | 1,196 |
| INCOME TAX EXPENSE | 558 | 495 | 404 |
| NET INCOME | 989 | 904 | 792 |
| Preferred stock dividend requirements | (11) | (11) | (11) |
| NET INCOME FOR COMMON STOCK | \$ 978 | \$ 893 | \$ 781 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Statement of Cash Flows

For the Twelve Months Ended December 31,

| (Millions of Dollars) | 2011 | 2010 | 2009 |
|---|----------------|----------------|----------------|
| OPERATING ACTIVITIES | | | |
| Net income | \$ 989 | \$ 904 | \$ 792 |
| PRINCIPAL NON-CASH CHARGES/(CREDITS) TO INCOME | | | |
| Depreciation and amortization | 829 | 787 | 744 |
| Deferred income taxes | 462 | 622 | 364 |
| Rate case amortization and accruals | 49 | 13 | (63) |
| Common equity component of allowance for funds used during construction | (8) | (13) | (12) |
| Other non-cash items (net) | 96 | (12) | (56) |
| CHANGES IN ASSETS AND LIABILITIES | | | |
| Accounts receivable – customers, less allowance for uncollectibles | 48 | (121) | 33 |
| Materials and supplies, including fuel oil and gas in storage | (2) | 4 | 133 |
| Other receivables and other current assets | 170 | 11 | (122) |
| Prepayments | (3) | - | 456 |
| Recoverable energy costs | - | - | 111 |
| Accounts payable | (132) | (17) | (118) |
| Pensions and retiree benefits | 102 | 68 | - |
| Superfund and environmental remediation costs (net) | (9) | (8) | (51) |
| Accrued taxes | 95 | 13 | (16) |
| Accrued interest | 3 | (7) | 6 |
| Deferred charges, noncurrent assets and other regulatory assets | (32) | (294) | 71 |
| Deferred credits and other regulatory liabilities | 224 | 70 | (25) |
| Other liabilities | 52 | 185 | (25) |
| NET CASH FLOWS FROM OPERATING ACTIVITIES | 2,933 | 2,205 | 2,222 |
| INVESTING ACTIVITIES | | | |
| Utility construction expenditures | (1,785) | (1,853) | (2,045) |
| Cost of removal less salvage | (162) | (145) | (176) |
| Loan to affiliate | - | - | 113 |
| NET CASH FLOWS USED IN INVESTING ACTIVITIES | (1,947) | (1,998) | (2,108) |
| FINANCING ACTIVITIES | | | |
| Net payments of short-term debt | - | - | (253) |
| Issuance of long-term debt | - | 925 | 1,350 |
| Retirement of long-term debt | - | (850) | (655) |
| Debt issuance costs | - | (9) | (10) |
| Capital contribution by parent | - | 355 | 211 |
| Dividend to parent | (681) | (670) | (652) |
| Preferred stock dividends | (11) | (11) | (11) |
| NET CASH FLOWS USED IN FINANCING ACTIVITIES | (692) | (260) | (20) |
| CASH AND TEMPORARY CASH INVESTMENTS: | | | |
| NET CHANGE FOR THE PERIOD | 294 | (53) | 94 |
| BALANCE AT BEGINNING OF PERIOD | 78 | 131 | 37 |
| BALANCE AT END OF PERIOD | \$ 372 | \$ 78 | \$ 131 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash paid/(refunded) during the period for: | | | |
| Interest | \$ 504 | \$ 528 | \$ 513 |
| Income taxes | \$ (198) | \$ (18) | \$ 18 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Balance Sheet

| (Millions of Dollars) | December 31, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and temporary cash investments | \$ 372 | \$ 78 |
| Accounts receivable – customers, less allowance for uncollectible accounts of \$79 and \$68 in 2011 and 2010, respectively | 977 | 1,025 |
| Other receivables, less allowance for uncollectible accounts of \$9 and \$7 in 2011 and 2010, respectively | 102 | 73 |
| Accrued unbilled revenue | 366 | 473 |
| Accounts receivable from affiliated companies | 54 | 273 |
| Fuel oil, gas in storage, materials and supplies, at average cost | 308 | 306 |
| Prepayments | 85 | 82 |
| Deferred tax assets – current | 157 | 131 |
| Regulatory assets | 140 | 151 |
| Other current assets | 100 | 104 |
| TOTAL CURRENT ASSETS | 2,661 | 2,696 |
| INVESTMENTS | 177 | 167 |
| UTILITY PLANT AT ORIGINAL COST | | |
| Electric | 19,886 | 18,735 |
| Gas | 4,200 | 3,844 |
| Steam | 1,983 | 2,038 |
| General | 1,785 | 1,746 |
| TOTAL | 27,854 | 26,363 |
| Less: Accumulated depreciation | 5,523 | 5,314 |
| Net | 22,331 | 21,049 |
| Construction work in progress | 1,165 | 1,345 |
| NET UTILITY PLANT | 23,496 | 22,394 |
| NON-UTILITY PROPERTY | | |
| Non-utility property, less accumulated depreciation of \$24 and \$22 in 2011 and 2010, respectively | 6 | 7 |
| NET PLANT | 23,502 | 22,401 |
| OTHER NONCURRENT ASSETS | | |
| Regulatory assets | 8,661 | 7,097 |
| Other deferred charges and noncurrent assets | 217 | 244 |
| TOTAL OTHER NONCURRENT ASSETS | 8,878 | 7,341 |
| TOTAL ASSETS | \$35,218 | \$32,605 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Balance Sheet

| (Millions of Dollars) | December 31, 2011 | December 31, 2010 |
|--|----------------------|----------------------|
| LIABILITIES AND SHAREHOLDER'S EQUITY | | |
| CURRENT LIABILITIES | | |
| Long-term debt due within one year | \$ 525 | \$ - |
| Accounts payable | 774 | 924 |
| Accounts payable to affiliated companies | 16 | 13 |
| Customer deposits | 290 | 276 |
| Accrued taxes | 32 | 34 |
| Accrued taxes to affiliated companies | 126 | 29 |
| Accrued interest | 133 | 130 |
| Accrued wages | 81 | 93 |
| Fair value of derivative liabilities | 98 | 71 |
| Regulatory liabilities | 79 | 131 |
| Other current liabilities | 396 | 400 |
| TOTAL CURRENT LIABILITIES | 2,550 | 2,101 |
| NONCURRENT LIABILITIES | | |
| Obligations under capital leases | 2 | 7 |
| Provision for injuries and damages | 173 | 159 |
| Pensions and retiree benefits | 4,337 | 2,900 |
| Superfund and other environmental costs | 373 | 392 |
| Asset retirement obligations | 145 | 109 |
| Fair value of derivative liabilities | 24 | 29 |
| Other noncurrent liabilities | 120 | 102 |
| TOTAL NONCURRENT LIABILITIES | 5,174 | 3,698 |
| DEFERRED CREDITS AND REGULATORY LIABILITIES | | |
| Deferred income taxes and investment tax credits | 6,921 | 6,202 |
| Regulatory liabilities | 861 | 683 |
| Other deferred credits | 61 | 42 |
| TOTAL DEFERRED CREDITS AND REGULATORY LIABILITIES | 7,843 | 6,927 |
| LONG-TERM DEBT (See Statement of Capitalization) | 9,220 | 9,743 |
| SHAREHOLDER'S EQUITY | | |
| Common shareholder's equity (See Statement of Common Shareholder's Equity) | 10,218 | 9,923 |
| Preferred stock (See Statement of Capitalization) | 213 | 213 |
| TOTAL SHAREHOLDER'S EQUITY | 10,431 | 10,136 |
| TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY | \$35,218 | \$32,605 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Statement of Comprehensive Income

| (Millions of Dollars) | For the Years Ended December 31, | | |
|---|---|-------------|-------------|
| | 2011 | 2010 | 2009 |
| NET INCOME | \$989 | \$904 | \$792 |
| OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | | | |
| Pension plan liability adjustments, net of \$(1), \$(1) and \$11 taxes in 2011, 2010 and 2009, respectively | (2) | (2) | 16 |
| TOTAL OTHER COMPREHENSIVE INCOME/(LOSS), NET OF TAXES | (2) | (2) | 16 |
| COMPREHENSIVE INCOME | \$987 | \$902 | \$808 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Statement of Common Shareholder's Equity

| (Millions of Dollars/Except Share Data) | Common Stock | | Additional Paid-In Capital | Retained Earnings | Repurchased Con Edison Stock | Capital Stock Expense | Accumulated Other Comprehensive Income/(Loss) | Total |
|---|--------------|--------|----------------------------|-------------------|------------------------------|-----------------------|---|----------|
| | Shares | Amount | | | | | | |
| BALANCE AS OF DECEMBER 31, 2008 | 235,488,094 | \$589 | \$3,664 | \$5,780 | \$(962) | \$(60) | \$(20) | \$ 8,991 |
| Net income | | | | 792 | | | | 792 |
| Common stock dividend to parent | | | | (652) | | | | (652) |
| Capital contribution by parent | | | 213 | | | (2) | | 211 |
| Cumulative preferred dividends | | | | (11) | | | | (11) |
| Other comprehensive income | | | | | | | 16 | 16 |
| BALANCE AS OF DECEMBER 31, 2009 | 235,488,094 | \$589 | \$3,877 | \$5,909 | \$(962) | \$(62) | \$ (4) | \$ 9,347 |
| Net income | | | | 904 | | | | 904 |
| Common stock dividend to parent | | | | (670) | | | | (670) |
| Capital contribution by parent | | | 357 | | | (2) | | 355 |
| Cumulative preferred dividends | | | | (11) | | | | (11) |
| Other comprehensive income | | | | | | | (2) | (2) |
| BALANCE AS OF DECEMBER 31, 2010 | 235,488,094 | \$589 | \$4,234 | \$6,132 | \$(962) | \$(64) | \$ (6) | \$ 9,923 |
| Net income | | | | 989 | | | | 989 |
| Common stock dividend to parent | | | | (681) | | | | (681) |
| Cumulative preferred dividends | | | | (11) | | | | (11) |
| Other comprehensive income | | | | | | | (2) | (2) |
| BALANCE AS OF DECEMBER 31, 2011 | 235,488,094 | \$589 | \$4,234 | \$6,429 | \$(962) | \$(64) | \$ (8) | \$10,218 |

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

Consolidated Edison Company of New York, Inc.
Consolidated Statement of Capitalization

| (Millions of Dollars) | Shares outstanding December 31, | | At December 31, | |
|---|------------------------------------|-------------|-----------------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| TOTAL COMMON SHAREHOLDER'S EQUITY BEFORE ACCUMULATED OTHER COMPREHENSIVE LOSS | 235,488,094 | 235,488,094 | \$10,226 | \$9,929 |
| Pension plan liability adjustments, net \$(3) and \$(2) taxes in 2011 and 2010, respectively | | | (5) | (3) |
| Unrealized gains/(losses) on derivatives qualified as cash flow hedges, less reclassification adjustment for gains/(losses) included in net income, net of \$(2) taxes in 2011 and 2010 | | | (3) | (3) |
| TOTAL ACCUMULATED OTHER COMPREHENSIVE LOSS, NET OF TAXES | | | (8) | (6) |
| TOTAL COMMON SHAREHOLDER'S EQUITY (SEE STATEMENT OF COMMON SHAREHOLDER'S EQUITY) | | | 10,218 | 9,923 |
| PREFERRED STOCK | | | | |
| \$5 Cumulative Preferred, without par value, authorized 1,915,319 shares | 1,915,319 | 1,915,319 | 175 | 175 |
| Cumulative Preferred, \$100 par value, authorized 6,000,000 shares | | | | |
| 4.65% Series C | 153,296 | 153,296 | 16 | 16 |
| 4.65% Series D | 222,330 | 222,330 | 22 | 22 |
| TOTAL PREFERRED STOCK | | | \$ 213 | \$ 213 |

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

Consolidated Edison Company of New York, Inc.
CONSOLIDATED STATEMENT OF CAPITALIZATION

| LONG-TERM DEBT (Millions of Dollars) | | | At December 31, | |
|---|---------------|----------------|-----------------|----------|
| Maturity | Interest Rate | Series | 2011 | 2010 |
| DEBENTURES: | | | | |
| 2012 | 5.625% | 2002A | \$ 300 | \$ 300 |
| 2013 | 4.875 | 2002B | 500 | 500 |
| 2013 | 3.85 | 2003B | 200 | 200 |
| 2014 | 4.70 | 2004A | 200 | 200 |
| 2014 | 5.55 | 2009A | 275 | 275 |
| 2015 | 5.375 | 2005C | 350 | 350 |
| 2016 | 5.50 | 2006C | 400 | 400 |
| 2016 | 5.30 | 2006D | 250 | 250 |
| 2018 | 5.85 | 2008A | 600 | 600 |
| 2018 | 7.125 | 2008C | 600 | 600 |
| 2019 | 6.65 | 2009B | 475 | 475 |
| 2020 | 4.45 | 2010A | 350 | 350 |
| 2033 | 5.875 | 2003A | 175 | 175 |
| 2033 | 5.10 | 2003C | 200 | 200 |
| 2034 | 5.70 | 2004B | 200 | 200 |
| 2035 | 5.30 | 2005A | 350 | 350 |
| 2035 | 5.25 | 2005B | 125 | 125 |
| 2036 | 5.85 | 2006A | 400 | 400 |
| 2036 | 6.20 | 2006B | 400 | 400 |
| 2036 | 5.70 | 2006E | 250 | 250 |
| 2037 | 6.30 | 2007A | 525 | 525 |
| 2038 | 6.75 | 2008B | 600 | 600 |
| 2039 | 5.50 | 2009C | 600 | 600 |
| 2040 | 5.70 | 2010B | 350 | 350 |
| TOTAL DEBENTURES | | | 8,675 | 8,675 |
| TAX-EXEMPT DEBT – Notes issued to New York State Energy Research and Development Authority for Facilities Revenue Bonds*: | | | | |
| 2032 | 0.193% | 2004B Series 1 | 127 | 127 |
| 2034 | 0.139 | 1999A | 293 | 293 |
| 2035 | 0.193 | 2004B Series 2 | 20 | 20 |
| 2036 | 0.222 | 2001B | 98 | 98 |
| 2036 | 1.45 | 2010A** | 225 | 225 |
| 2039 | 0.21 | 2004A | 98 | 98 |
| 2039 | 0.08 | 2004C | 99 | 99 |
| 2039 | 0.067 | 2005A | 126 | 126 |
| TOTAL TAX-EXEMPT DEBT | | | 1,086 | 1,086 |
| Unamortized debt discount | | | (16) | (18) |
| TOTAL | | | 9,745 | 9,743 |
| Less: long-term debt due within one year | | | 525 | - |
| TOTAL LONG-TERM DEBT | | | 9,220 | 9,743 |
| TOTAL CAPITALIZATION | | | \$19,651 | \$19,879 |

* Other than Series 2010A, rates reset weekly or by auction held every 35 days; December 30, 2011 rates shown.

** Subject to mandatory tender in 2012.

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

Notes to the Financial Statements

General

These combined notes accompany and form an integral part of the separate consolidated financial statements of each of the two separate registrants: Consolidated Edison, Inc. and its subsidiaries (Con Edison) and Consolidated Edison Company of New York, Inc. and its subsidiaries (CECONY). CECONY is a subsidiary of Con Edison and as such its financial condition and results of operations and cash flows, which are presented separately in the CECONY consolidated financial statements, are also consolidated, along with those of Con Edison's other utility subsidiary, Orange and Rockland Utilities, Inc. (O&R), and Con Edison's competitive energy businesses (discussed below) in Con Edison's consolidated financial statements. The term "Utilities" is used in these notes to refer to CECONY and O&R.

As used in these notes, the term "Companies" refers to Con Edison and CECONY and, except as otherwise noted, the information in these combined notes relates to each of the Companies. However, CECONY makes no representation as to information relating to Con Edison or the subsidiaries of Con Edison other than itself.

Con Edison has two regulated utility subsidiaries: CECONY and O&R. CECONY provides electric service and gas service in New York City and Westchester County. The company also provides steam service in parts of Manhattan. O&R, along with its regulated utility subsidiaries, provides electric service in southeastern New York and adjacent areas of northern New Jersey and eastern Pennsylvania and gas service in southeastern New York and adjacent areas of eastern Pennsylvania. Con Edison has the following competitive energy businesses: Consolidated Edison Solutions, Inc. (Con Edison Solutions), a retail energy services company that sells electricity and also offers energy-related services; Consolidated Edison Energy, Inc. (Con Edison Energy), a wholesale energy supply and services company; and Consolidated Edison Development, Inc. (Con Edison Development), a company that develops and participates in infrastructure projects.

Note A — Summary of Significant Accounting Policies

Principles of Consolidation

The Companies' consolidated financial statements include the accounts of their respective majority-owned subsidiaries, and variable interest entities (see Note Q), as required. All intercompany balances and transactions have been eliminated.

Accounting Policies

The accounting policies of Con Edison and its subsidiaries conform to accounting principles generally accepted in the United States of America. For the Utilities, these accounting principles include the accounting rules for regulated operations

and the accounting requirements of the Federal Energy Regulatory Commission (FERC) and the state public utility regulatory commissions having jurisdiction.

The accounting rules for regulated operations specify the economic effects that result from the causal relationship of costs and revenues in the rate-regulated environment and how these effects are to be accounted for by a regulated enterprise. Revenues intended to cover some costs may be recorded either before or after the costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, these costs would be recorded as deferred charges or "regulatory assets" under the accounting rules for regulated operations. If revenues are recorded for costs that are expected to be incurred in the future, these revenues would be recorded as deferred credits or "regulatory liabilities" under the accounting rules for regulated operations.

The Utilities' principal regulatory assets and liabilities are detailed in Note B. The Utilities are receiving or being credited with a return on all of their regulatory assets for which a cash outflow has been made, and are paying or being charged with a return on all of their regulatory liabilities for which a cash inflow has been received. The Utilities' regulatory assets and liabilities will be recovered from customers, or applied for customer benefit, in accordance with rate provisions approved by the applicable public utility regulatory commission.

Other significant accounting policies of the Companies are referenced below in this Note A and in the notes that follow.

Plant and Depreciation

Utility Plant

Utility plant is stated at original cost. The cost of repairs and maintenance is charged to expense and the cost of betterments is capitalized. The capitalized cost of additions to utility plant includes indirect costs such as engineering, supervision, payroll taxes, pensions, other benefits and an allowance for funds used during construction (AFDC). The original cost of property is charged to expense over the estimated useful lives of the assets. Upon retirement, the original cost of property is charged to accumulated depreciation. See Note R. Rates used for AFDC include the cost of borrowed funds and a reasonable rate of return on the Utilities' own funds when so used, determined in accordance with regulations of the FERC or the state public utility regulatory authority having jurisdiction. The rate is compounded semiannually, and the amounts applicable to borrowed funds are treated as a reduction of interest charges, while the amounts applicable to the Utilities' own funds are credited to other income (deductions). The AFDC rates for CECONY were 6.9 percent, 5.3 percent and 6.9 percent for 2011, 2010, and 2009, respectively. The AFDC rates for O&R were 6.6 percent, 5.8 percent and 4.2 percent for 2011, 2010, and 2009, respectively.

Notes to the Financial Statements — Continued

The Utilities generally compute annual charges for depreciation using the straight-line method for financial statement purposes, with rates based on average service lives and net salvage factors. The average depreciation rate for CECONY was 3.1 percent for 2011, 2010, and 2009. The average depreciation rate for O&R was 2.8 percent for 2011, 2010, and 2009.

The estimated lives for utility plant for CECONY range from 5 to 80 years for electric, 5 to 85 years for gas, 5 to 70 years for steam and 5 to 50 years for general plant. For O&R, the estimated lives for utility plant range from 5 to 75 years for electric, 5 to 75 years for gas and 5 to 50 years for general plant.

At December 31, 2011 and 2010, the capitalized cost of the Companies' utility plant, net of accumulated depreciation, was as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|-------------------------------|------------|----------|----------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Electric | | | | |
| Generation | \$ 400 | \$ 396 | \$ 400 | \$ 396 |
| Transmission | 2,654 | 2,284 | 2,476 | 2,150 |
| Distribution | 13,805 | 13,191 | 13,125 | 12,549 |
| Gas* | 3,858 | 3,535 | 3,455 | 3,153 |
| Steam | 1,651 | 1,617 | 1,651 | 1,617 |
| General | 1,282 | 1,241 | 1,162 | 1,125 |
| Held for future use | 74 | 72 | 62 | 60 |
| Construction work in progress | 1,241 | 1,458 | 1,165 | 1,344 |
| Net Utility Plant | \$24,965 | \$23,794 | \$23,496 | \$22,394 |

* Primarily distribution.

Under the Utilities' current rate plans, the aggregate annual depreciation allowance in effect at December 31, 2011 was \$877 million, including \$834 million under CECONY's electric, gas and steam rate plans that have been approved by the New York State Public Service Commission (NYSPSC).

Non-Utility Plant

Non-utility plant is stated at original cost and consists primarily of land, telecommunication, gas storage and solar facilities that are currently not used within electric, gas or steam utility operations. Depreciation on these assets is computed using the straight-line method for financial statement purposes over their estimated useful lives, which range from 3 to 30 years.

Goodwill

In accordance with the accounting rules for goodwill and intangible assets, Con Edison is required to test goodwill for impairment annually. Goodwill is tested for impairment using a two-step approach. The first step of the goodwill impairment test

compares the estimated fair value of a reporting unit with its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not impaired. If the carrying value exceeds the estimated fair value of the reporting unit, the second step is performed to measure the amount of impairment loss, if any. The second step requires a calculation of the implied fair value of goodwill. See Note K and Note T.

Impairments

In accordance with the accounting rules for impairment or disposal of long-lived assets, the Companies evaluate the impairment of long-lived assets, based on projections of undiscounted future cash flows, whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. In the event an evaluation indicates that such cash flows cannot be expected to be sufficient to fully recover the assets, the assets are written down to their estimated fair value.

In accordance with the accounting rules for equity method and joint ventures, Con Edison Development recognized a pre-tax impairment charge of \$5 million in 2009, related to its equity investment in an electric generating plant in Guatemala (which was sold in 2010). No impairment charges were recognized in 2011 and 2010.

Revenues

The Utilities and Con Edison Solutions recognize revenues for energy service on a monthly billing cycle basis. The Utilities defer over a 12-month period net interruptible gas revenues, other than those authorized by the NYSPSC to be retained by the Utilities, for refund to firm gas sales and transportation customers. The Utilities and Con Edison Solutions accrue revenues at the end of each month for estimated energy service not yet billed to customers. Prior to March 31, 2009, CECONY did not accrue revenues for energy service provided but not yet billed to customers except for certain unbilled gas revenues accrued in 1989. This change in accounting for unbilled revenues had no effect on net income. See "Regulatory Assets and Liabilities" in Note B. Unbilled revenues included in Con Edison's balance sheet at December 31, 2011 and 2010 were \$474 million (including \$366 million for CECONY) and \$633 million (including \$473 million for CECONY), respectively.

CECONY's electric and gas rate plans and O&R's New York electric and gas rate plans each contain a revenue decoupling mechanism under which the company's actual energy delivery revenues are compared on a periodic basis, with the authorized delivery revenues and the difference accrued, with interest, for refund to, or recovery from, customers, as applicable. See "Rate Agreements" in Note B.

Notes to the Financial Statements — Continued

The NYSPSC requires utilities to record gross receipts tax revenues and expenses on a gross income statement presentation basis (i.e., included in both revenue and expense). The recovery of these taxes is generally provided for in the revenue requirement within each of the respective NYSPSC approved rate plans.

Recoverable Energy Costs

The Utilities generally recover all of their prudently incurred fuel, purchased power and gas costs, including hedging gains and losses, in accordance with rate provisions approved by the applicable state public utility commissions. If the actual energy supply costs for a given month are more or less than the amounts billed to customers for that month, the difference in most cases is recoverable from or refundable to customers. Differences between actual and billed electric and steam supply costs are generally deferred for charge or refund to customers during the next billing cycle (normally within one or two months). In addition, CECONY recovers the costs of its electric demand management program, in excess of the costs reflected in rates, as part of recoverable energy costs. For the Utilities' gas costs, differences between actual and billed gas costs during the 12-month period ending each August are charged or refunded to customers during a subsequent 12-month period.

New York Independent System Operator (NYISO)

The Utilities purchase electricity through the wholesale electricity market administered by the NYISO. The difference between purchased power and related costs initially billed to the Utilities by the NYISO and the actual cost of power subsequently calculated by the NYISO is refunded by the NYISO to the Utilities, or paid to the NYISO by the Utilities. The reconciliation payments or receipts are recoverable from or refundable to the Utilities' customers.

Certain other payments to or receipts from the NYISO are also subject to reconciliation, with shortfalls or amounts in excess of specified rate allowances recoverable from or refundable to customers. These include proceeds from the sale through the NYISO of transmission rights on CECONY's transmission system (transmission congestion contracts or TCCs).

Sulfur Dioxide (SO₂) Allowances

In accordance with the federal Clean Air Act, CECONY has been allocated SO₂ emission allowances which the company may sell, trade or hold for future use. Generally, CECONY defers its proceeds from the sale of SO₂ allowances as regulatory liabilities to be applied for customer benefit. The proceeds received from the sale of SO₂ allowances are included in net cash flows from operating activities in the Companies' consolidated statements of cash flows.

Temporary Cash Investments

Temporary cash investments are short-term, highly-liquid investments that generally have maturities of three months or less at the date of purchase. They are stated at cost, which approximates market. The Companies consider temporary cash investments to be cash equivalents.

Investments

Investments consist primarily of the investments of Con Edison's competitive energy businesses, which are accounted for under the equity method (depending on the subsidiaries' percentage ownership) or accounted for as leveraged leases in accordance with the accounting rules for leases. See Note J for a discussion of investments in Lease In/Lease Out transactions. Utilities' investments are recorded at fair value and include the deferred income plan and supplemental retirement income plan trust owned life insurance assets.

Pension and Other Postretirement Benefits

The accounting rules for retirement benefits require an employer to recognize an asset or liability for the overfunded or underfunded status of its pension and other postretirement benefit plans. For a pension plan, the asset or liability is the difference between the fair value of the plan's assets and the projected benefit obligation. For any other postretirement benefit plan, the asset or liability is the difference between the fair value of the plan's assets and the accumulated postretirement benefit obligation. The accounting rules generally require employers to recognize all unrecognized prior service costs and credits and unrecognized actuarial gains and losses in accumulated other comprehensive income (OCI), net of tax. Such amounts will be adjusted as they are subsequently recognized as components of net periodic benefit cost or income pursuant to the current recognition and amortization provisions.

For the Utilities' pension and other postretirement benefit plans, regulatory accounting treatment is generally applied in accordance with the accounting rules for regulated operations. Unrecognized prior service costs or credits and unrecognized actuarial gains and losses are recorded to regulatory assets or liabilities, rather than OCI. See Notes E and F.

The net periodic benefit costs are recognized in accordance with the accounting rules for retirement benefits. Investment gains and losses are recognized in expense over a 15-year period and other actuarial gains and losses are recognized in expense over a 10-year period, subject to the deferral provisions in the rate plans.

In accordance with the Statement of Policy issued by the NYSPSC and its current electric, gas and steam rate agreements, CECONY defers for payment to or recovery from customers the difference between such expenses and the amounts for such expenses

Notes to the Financial Statements — Continued

reflected in rates. Generally, O&R also defers such difference pursuant to its rate plans. See Note B – Regulatory Matters.

The Companies calculate the expected return on pension and other retirement benefit plan assets by multiplying the expected rate of return on plan assets by the market-related value (MRV) of plan assets at the beginning of the year, taking into consideration anticipated contributions and benefit payments that are to be made during the year. The accounting rules allow the MRV of plan assets to be either fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. The Companies use a calculated value when determining the MRV of the plan assets that adjusts for 20 percent of the difference between fair value and expected MRV of plan assets. This calculated value has the effect of stabilizing variability in assets to which the Companies apply the expected return.

Federal Income Tax

In accordance with the accounting rules for income taxes, the Companies have recorded an accumulated deferred federal income tax liability for temporary differences between the book and tax basis of assets and liabilities at current tax rates. In accordance with rate agreements, the Utilities have recovered amounts from customers for a portion of the tax liability they will pay in the future as a result of the reversal or “turn-around” of these temporary differences. As to the remaining tax liability, in accordance with the accounting rules for regulated operations, the Utilities have established regulatory assets for the net revenue requirements to be recovered from customers for the related future tax expense. See Notes B and L. In 1993, the NYS PSC issued a Policy Statement approving accounting procedures consistent with the accounting rules for income taxes and providing assurances that these future increases in taxes will be recoverable in rates. See Note L.

Accumulated deferred investment tax credits are amortized ratably over the lives of the related properties and applied as a reduction to future federal income tax expense.

The Companies’ federal income tax returns reflect certain tax positions with which the Internal Revenue Service (IRS) does not or may not agree. See “Lease In/Lease Out Transactions” in Note J and “Uncertain Tax Positions” in Note L.

Con Edison and its subsidiaries file a consolidated federal income tax return. The consolidated income tax liability is allocated to each member of the consolidated group using the separate return method. Each member pays or receives an amount based on its own taxable income or loss in accordance with tax sharing agreements between the members of the consolidated group.

State Income Tax

Con Edison and its subsidiaries file a combined New York State Corporation Business Franchise Tax Return. Similar to a federal consolidated income tax return, the income of all entities in the combined group is subject to New York State taxation, after adjustments for differences between federal and New York law and apportionment of income among the states in which the company does business. Each member of the group pays or receives an amount based on its own New York State taxable income or loss.

Research and Development Costs

Generally research and development costs are charged to operating expenses as incurred. Research and development costs were as follows:

| (Millions of Dollars) | For the Years Ended December 31, | | |
|-----------------------|----------------------------------|------|------|
| | 2011 | 2010 | 2009 |
| Con Edison | \$23 | \$23 | \$27 |
| CECONY | \$21 | \$21 | \$25 |

Reclassification

Certain prior year amounts have been reclassified to conform with the current year presentation.

Earnings Per Common Share

In accordance with the accounting rules for earnings per share, Con Edison presents basic and diluted earnings per share on the face of its consolidated income statement. Basic earnings per share (EPS) are calculated by dividing earnings available to common shareholders (“Net income for common stock” on Con Edison’s consolidated income statement) by the weighted average number of Con Edison common shares outstanding during the period. In the calculation of diluted EPS, weighted average shares outstanding are increased for additional shares that would be outstanding if potentially dilutive securities were converted to common stock.

Potentially dilutive securities for Con Edison consist of restricted stock units, deferred stock units and stock options for which the average market price of the common shares for the period was greater than the exercise price. See Note M.

Notes to the Financial Statements — Continued

Basic and diluted EPS for Con Edison are calculated as follows:

| (Millions of Dollars, except per share amounts/Shares in Millions) | For the Years Ended December 31, | | |
|---|-------------------------------------|---------|---------|
| | 2011 | 2010 | 2009 |
| Net income for common stock | \$1,051 | \$ 992 | \$ 868 |
| Weighted average common shares outstanding – Basic | 292.6 | 284.3 | 275.2 |
| Add: Incremental shares attributable to effect of potentially dilutive securities | 1.8 | 1.6 | 1.1 |
| Adjusted weighted average common shares outstanding – Diluted | 294.4 | 285.9 | 276.3 |
| Net Income for common stock per common share – basic | \$ 3.59 | \$ 3.49 | \$ 3.16 |
| Net Income for common stock per common share – diluted | \$ 3.57 | \$ 3.47 | \$ 3.14 |

The computation of diluted earnings per share excludes immaterial amounts of incremental Con Edison common shares for the years ended December 31, 2010 and 2009 because the exercise prices on the options exceeded the average closing market price during these periods. No such exclusion was required for the computation of diluted earnings per share for the year ended December 31, 2011.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Note B — Regulatory Matters

Rate Agreements

CECONY — Electric

The NYSPSC's March 2008 and April 2009 orders and the November 2009 Joint Proposal covering CECONY's electric rates, discussed below, provided for the collection of a portion of the company's electric revenues (\$237 million in the rate year ended March 2009, \$254 million for the rate year ended March 2010 and, rate year ended March 2011, \$249 million on an annual basis) subject to potential refund to customers following NYSPSC review and completion of an investigation by the NYSPSC staff of the company's capital expenditures during the April 2005 through March 2008 period for transmission and distribution utility plant (the 2005-2008 Capital Expenditure Review). In December 2009, the company established a \$24 million regulatory liability for refund to customers with respect to this matter and recognized a \$14 million (after-tax) charge in its 2009 consolidated financial statements. In March 2010, the NYSPSC issued an order approving a February 2010 Joint Proposal by the company and the NYSPSC staff relating to this matter pursuant to which the company, among other things, provided a \$36 million credit to customer bills in 2010.

In March 2008, the NYSPSC adopted an order, issued and effective March 25, 2008, granting CECONY an electric rate increase, effective April 1, 2008, of \$425 million.

The NYSPSC ruling reflected the following major items:

- a return on common equity of 9.1 percent;
- an increase to \$150 million from \$60 million in the level of annual revenues that, for purposes of setting rates, it is assumed the company will receive and retain from the sale of transmission rights on the company's transmission system, with the difference between such actual revenues for the rate year and \$150 million to be recoverable from or refundable to customers, as the case may be;
- collection of \$237 million of the \$425 million rate increase is subject to potential refund to customers following the 2005-2008 Capital Expenditure Review (see discussion above in this Note B of the February 2010 Joint Proposal);
- continuation of the rate provisions under which pension and other postretirement benefit expenses and environmental remediation expenses are reconciled to amounts reflected in rates;
- change to the reconciliation provisions for transmission and distribution expenditures and costs to relocate facilities to accommodate government projects, which under the NYSPSC ruling will be reconciled only to the extent actual expenditures are less than amounts reflected in rates;
- discontinuation of the provisions under which property taxes were reconciled to amounts reflected in rates;
- potential operations penalties of up to \$152 million annually if certain customer service and system reliability performance targets are not met;

Notes to the Financial Statements — Continued

- implementation of a revenue decoupling mechanism under which the company's actual energy delivery revenues would be compared, on a periodic basis, with the authorized delivery revenues and the difference accrued, with interest, for refund to, or recovery from, customers, as applicable; and
- continuation of the rate provisions pursuant to which the company recovers its purchased power and fuel costs from customers.

In April 2009, the NYSPSC adopted an order granting CECONY an electric rate increase, effective April 6, 2009, of \$523 million. The NYSPSC ruling reflects the following major items:

- A return on common equity of 10.0 percent, based on certain assumptions, including a common equity ratio of 48 percent and achievement by the company of unspecified austerity measures required by the NYSPSC that would result in avoided revenue requirements of \$60 million;
- continuation of the revenue decoupling mechanism (in 2009, the company increased revenues by \$122 million pursuant to this mechanism and the corresponding provision of the March 2008 rate order);
- a decrease to \$120 million from \$150 million in the level of annual revenues that, for purposes of setting rates, it is assumed the company will receive and retain from the sale of transmission rights on the company's transmission system, with the difference between such actual revenues for the rate year and \$120 million to be recoverable from or refundable to customers, as the case may be (in 2009, the company accrued \$7 million of revenues under this provision and the corresponding provision of the March 2008 rate order);
- reconciliation of the actual amount of pension and other postretirement benefit costs, environmental remediation expenses, property taxes and the cost of long-term debt to amounts reflected in rates (in 2009, the company deferred recognition of \$36.4 million of expenses under these provisions and the corresponding provisions of the March 2008 rate order);
- if actual generation, transmission, distribution and shared service plant expenditures (other than removal costs) and capital costs incurred to relocate facilities to accommodate government projects are less than amounts reflected in rates for the respective category of expenditures, the company will accrue a regulatory liability and reduce its revenues by the revenue requirement impact of the difference (i.e., return on

investment, depreciation and income taxes) (in 2009, the company did not reduce revenues under these provisions and the corresponding provisions of the March 2008 rate order);

- collection of a surcharge (in addition to the electric rate increase) from customers in connection with an increase (estimated at \$198 million), effective April 2009, in a New York State assessment;
- continuation of provisions for potential operations penalties of up to \$152 million annually if certain customer service and system reliability performance targets are not met (in 2009, the company did not reduce revenues under these provisions and the corresponding provisions of the March 2008 rate order);
- continuation of the collection of a portion (increased, to reflect higher capital costs, from \$237 million collected in the rate year ended March 2009 to \$254 million for the rate year ending March 2010) of the April 2008 rate increase subject to potential refund to customers following the 2005-2008 Capital Expenditure Review (see discussion above in this Note B of the February 2010 Joint Proposal). The portion collected is also subject to refund in the event the NYSPSC determines that some disallowance of costs the company has recovered is warranted to address potential impacts of alleged unlawful conduct by arrested employees and contractors (see "Other Regulatory Matters" below in this Note B and "Investigations of Vendor Payments" in Note H); and
- continuation of the rate provisions pursuant to which the company recovers its purchased power and fuel costs from customers.

In May 2009, the company filed with the NYSPSC the company's plan with respect to austerity measures that would reduce the company's revenue requirements during the rate year ending March 31, 2010 by \$60 million. The company's austerity plans include reductions in labor costs, including compensation and other employee benefits, deferral of expenditures for capital projects and operating and maintenance programs and other initiatives. These reductions collectively represent \$47 million of the \$60 million reduction sought by the NYSPSC. In May 2009, the company filed with the NYSPSC a request for rehearing of the NYSPSC's April 2009 order with respect to its austerity provisions and certain other matters. Pursuant to the February 2010 Joint Proposal (discussed above in Note B), the company withdrew this request.

In November 2009, CECONY, the NYSPSC staff and other parties entered into a Joint Proposal with respect to the

Notes to the Financial Statements — Continued

company's May 2009 request to the NYSPSC for an increase in the rates the company can charge its customers for electric delivery service. The Joint Proposal, which was approved in March 2010, covers the three-year period April 2010 through March 2013 and provides for electric base rate increases of \$420 million, effective April 2010 and 2011, and \$287 million, effective April 2012, with an additional \$133 million to be collected through a surcharge in the rate year ending March 2013. In January 2012, the NYSPSC issued a notice soliciting comments relating to the possible use of certain of the company's regulatory liabilities (that would otherwise be refundable to or applied for the benefit of customers after the rate year ended March 2013) to offset all or a portion of such surcharge.

The Joint Proposal reflects the following major items:

- A weighted average cost of capital of 7.76 percent, reflecting:
 - return on common equity of 10.15 percent, assuming achievement by the company of unspecified austerity measures that would result in reductions in operations and maintenance expenses of \$27 million, \$20 million and \$13 million in the rate years ending March 2011, 2012 and 2013, respectively;
 - cost of long-term debt of 5.65 percent;
 - common equity ratio of 48 percent; and
 - average rate base of \$14,887 million, \$15,987 million and \$16,826 million for the rate years ending March 2011, 2012 and 2013, respectively.
- Deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which (A) actual average net plant balances allocable to the company's electric business for (i) transmission and distribution, excluding municipal infrastructure support (T&D), (ii) generation, shared services and, subject to certain adjustments, municipal infrastructure support (Other) and (iii) a finance and supply chain enterprise resource project (ERP) are less than (B) amounts reflected in rates for the respective category for each rate year. The amounts reflected in rates are:

| (Millions of Dollars) | Rate Year Ending March 31, | | |
|-----------------------|----------------------------|----------|----------|
| | 2011 | 2012 | 2013 |
| T&D | \$13,818 | \$14,742 | \$15,414 |
| Other | 1,487 | 1,565 | 1,650 |
| ERP | - | 25 | 115 |
- Any deferral for T&D and Other for the rate year ending March 2011 will be based on average net plant balances for the year and for the rate years ending March 2012 and 2013 will be based on average net plant balances over the term of the Joint Proposal. The company has deferred \$8 million as a regulatory liability pursuant to this provision in 2011.
- Any deferral for ERP would be based on average net plant balances for ERP over the term of the Joint Proposal.
- During the term of the Joint Proposal, the company will not accrue any additional revenue for carrying charges on any capital expenditures allocable to its electric business in excess of specified limits (which limits exclude certain expenditures, including expenditures for projects for which the company has been selected to receive grants under the American Recovery and Reinvestment Act of 2009):
 - T&D capital expenditures – \$1,200 million for the rate year ending March 2011 and an aggregate \$2,300 million for the period from April 2011 through March 2013 (such capital expenditures for the rate year ended March 2011 were less than \$1,200 million);
 - Other capital expenditures – \$220 million for the rate year ending March 2011 and an aggregate \$402 million for the period from April 2011 through March 2013 (such capital expenditures for the rate year ended March 2011 were less than \$220 million); and
 - ERP capital expenditures – \$125 million (such capital expenditures for the rate year ended March 2011 were less than \$125 million).
- The company is not precluded from seeking to recover in rates effective after March 2013 the annual revenue requirement for T&D and Other capital expenditures made during the term of the Joint Proposal in excess of the applicable capital expenditure limit; provided that:
 - the company can justify the need for and reasonableness of, and the company's inability to reasonably avoid, such excess capital expenditures; and
 - the return on investment for any such excess T&D or Other capital expenditures made during the rate year ending March 2011 will be calculated based on the company's overall cost of debt. There were no such excess expenditures for the rate year ended March 31, 2011.

Notes to the Financial Statements — Continued

- Sharing with electric customers of any actual earnings, excluding the effects of any penalties and certain other items, above specified percentage returns on equity (based on actual average common equity ratio, subject to a 50 percent maximum) as follows:
 - for the rate year ending March 2011, the company will allocate to customers the revenue requirement equivalent of 50 percent of earnings above 11.15 percent up to and including 12.149 percent, 75 percent of earnings equal to or in excess of 12.15 percent up to and including 13.149 percent and 90 percent of earnings equal to or in excess of 13.15 percent (earnings were not above 11.15 percent for the rate year ended March 2011);
 - for the rate years ending March 2012 and 2013, the company will allocate to customers the revenue requirement equivalent of 60 percent of the earnings, calculated on a cumulative basis for such years, in excess of 10.65 percent up to and including 12.149 percent, 75 percent of such cumulative earnings equal to or in excess of 12.15 percent up to and including 13.149 percent and 90 percent of such cumulative earnings equal to or in excess of 13.15 percent;
 - the customers' share of any such earnings and 50 percent of the company's share would be applied to reduce regulatory assets for pensions and other postretirement benefits and other costs; and
 - in the event the company does not file for a rate increase to take effect in April 2013, the earnings sharing levels for the rate year ending March 2013 will continue in effect, calculated on an annual basis, until base rates are reset by the NYSPSC.
- Deferral as a regulatory asset or liability, as the case may be, of differences between the actual level of certain expenses, including, among others, expenses for pension and other postretirement benefits, environmental remediation, relocation of facilities to accommodate government projects, property taxes and (for the rate years ending March 2012 and 2013) long-term debt, and amounts for those expenses reflected in rates (with deferral for the difference in property taxes limited to 80 percent of the difference, subject to annual maximum for the remaining 20 percent of the difference of not more than a 10 basis point impact on return on common equity and deferral of facility relocation expenses in excess amounts reflected in rates subject to certain limitations). In 2010 and 2011, the company deferred \$264 million as a net regulatory asset, and \$39 million as a net regulatory liability, respectively, under these provisions and the corresponding provisions of the April 2009 rate order.
- Continuation of the provisions in the April 2009 order relating to revenues from the sale of transmission rights on the company's transmission system. In 2010 and 2011, the company accrued \$9 million and \$26 million of revenues, respectively, under this provision and the corresponding provision of the April 2009 rate order.
- Continuation of the revenue decoupling mechanism under which the company's actual electric delivery revenues would be compared, on a periodic basis, with the delivery revenues reflected in rates, and the difference accrued as a regulatory liability (for refund to electric customers) or a regulatory asset (for recovery from electric customers), as the case may be. In 2010 and 2011, the company deferred for customer benefit \$124 million and \$90 million of revenues, respectively, under this provision and the corresponding provision of the April 2009 rate order.
- Continuation of the rate provisions pursuant to which the company recovers its purchased power and fuel costs from electric customers.
- Continuation of provisions for potential operations penalties of up to \$152 million annually if certain electric customer service and system reliability performance targets are not met. In 2010 and 2009, the company did not recognize any expenses under these provisions and the corresponding provisions of the April 2009 order. In 2011, the company recognized a \$5 million system reliability penalty.
- Collection from electric customers of \$249 million on an annual basis subject to potential refund following the 2005-2008 Capital Expenditure Review (see discussion above in this Note B of the February 2010 Joint Proposal). The amount to be collected would also be subject to refund in the event the NYSPSC determined that some disallowance of costs the company has recovered is warranted to address potential impacts of alleged unlawful conduct by arrested employees and contractors (see "Other Regulatory Matters" below in this Note B and "Investigations of Vendor Payments" in Note H).

O&R — Electric

In July 2008, the NYSPSC approved a Joint Proposal among O&R, the NYSPSC staff and other parties for the rates O&R can charge its New York customers for electric service from July 2008 through June 2011. The rate plan approved by the

Notes to the Financial Statements — Continued

NYSPSC provides for electric rate increases of \$15.6 million, \$15.6 million and \$5.7 million effective July 1, 2008, 2009 and 2010, respectively, and the collection of an additional \$9.9 million during the 12-month period beginning July 1, 2010.

The Joint Proposal reflected the following major items:

- an annual return on common equity of 9.4 percent;
- most of any actual earnings above a 10.2 percent return on equity (based on actual average common equity ratio, subject to a 50 percent maximum) are to be applied to reduce regulatory assets for pension and other postretirement benefit expenses (the company did not reduce regulatory assets under this provision in 2011, 2010, or 2009);
- deferral as a regulatory asset or regulatory liability, as the case may be, of the difference between actual pension and other postretirement benefit expenses, environmental remediation expenses, property taxes, tax-exempt debt costs and certain other expenses and amounts for those expenses reflected in rates (the company deferred recognition of \$0.3 million of expenses, \$0.7 million of revenue and \$3 million of expenses under this provision in 2011, 2010, and 2009, respectively);
- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which actual transmission and distribution related capital expenditures are less than amounts reflected in rates (the company deferred \$7 million, \$12 million, and \$8 million of revenues under this provision in 2011, 2010, and 2009, respectively);
- deferral as a regulatory asset of increases, if any, in certain expenses above a 4 percent annual inflation rate, but only if the actual annual return on common equity is less than 9.4 percent (the company did not defer any expenses under this provision in 2011, 2010 or 2009);
- potential negative earnings adjustments of up to \$3 million annually if certain customer service and system reliability performance targets are not met (the company met the performance targets in 2011 and 2009; the company reduced revenues by \$1 million under this provision in 2010);
- implementation of a revenue decoupling mechanism under which actual energy delivery revenues would be compared, on a periodic basis, with the authorized

delivery revenues with the difference accrued, with interest, for refund to, or recovery from, customers, as applicable (the company accrued \$3.3 million, \$5.1 million, and \$12.5 million of revenues pursuant to this provision in 2011, 2010, and 2009, respectively);

- continuation of the rate provisions pursuant to which the company recovers its purchased power costs from customers; and
- withdrawal of the litigation O&R commenced seeking to annul the NYSPSC's March and October 2007 orders relating to O&R's electric rates.

In June 2011, the NYSPSC adopted an order granting O&R an electric rate increase, effective July 1, 2011, of \$26.6 million. The NYSPSC ruling reflects the following major items:

- a weighted average cost of capital of 7.22 percent, reflecting:
 - a return on common equity of 9.2 percent, assuming achievement by the company of \$825,000 of austerity measures;
 - cost of long-term debt of 5.50 percent; and
 - common equity ratio of 48 percent.
- continuation of a revenue decoupling mechanism;
- a provision for reconciliation of certain differences in actual average net utility plant to the amount reflected in rates (\$718 million) and continuation of rate provisions under which pension and other postretirement benefit expenses, environmental remediation expenses, tax-exempt debt costs and certain other expenses are reconciled to amounts for those expenses reflected in rates;
- continuation of the rate provisions pursuant to which the company recovers its purchased power costs from customers;
- discontinuation of the provisions under which property taxes were reconciled to amounts reflected in rates;
- discontinuation of the inclusion in rates of funding for the company's annual incentive plan for non-officer management employees;
- continuation of provisions for potential operations penalties of up to \$3 million annually if certain customer service and system reliability performance targets are not met (in 2011, O&R did not recognize any operations penalties under these provisions or the corresponding provisions of the Joint Proposal discussed above); and

Notes to the Financial Statements — Continued

- O&R is directed to produce a report detailing its implementation plans for the recommendations made in connection with the NYSPSC's management audit of CECONY, with a forecast of costs to achieve and expected savings. (See "Rate Agreements – Other Regulatory Matters" below in this Note B).

In July 2011, O&R filed a request with the NYSPSC for an increase in the rates it charges for electric service rendered in New York, effective July 1, 2012, of \$17.7 million. The filing reflects a return on common equity of 10.75 percent and a common equity ratio of 49.4 percent. Among other things, the filing proposes continuation of the current provisions with respect to recovery from customers of the cost of purchased power and with respect to the deferral of differences between actual expenses allocable to the electric business for pensions and other postretirement benefits, environmental, and research and developmental costs to the amounts for such costs reflected in electric rates. The filing also includes an alternative proposal for a three-year electric rate plan with annual rate increases of \$17.6 million effective July 2012, 2013 and 2014. The multi-year filing reflects a return on common equity of 11.25 percent. In December 2011, to reflect certain increased costs, the company updated the requested July 1, 2012 increase to \$31.4 million and the alternative three-year rate plan's annual increases to \$22.2 million.

In March 2007, the New Jersey Board of Public Utilities (NJBPU) approved a three-year electric base rate plan for Rockland Electric Company (RECO), O&R's New Jersey regulated utility subsidiary that went into effect on April 1, 2007. The plan provides for a \$6.4 million rate increase during the first year, with no further increase during the final two years. The plan reflects a return on common equity of 9.75 percent and a common equity ratio of 46.5 percent of capitalization.

In May 2010, RECO, the Division of Rate Counsel, Staff of the NJBPU and certain other parties entered into a stipulation of settlement with respect to the company's August 2009 request to increase the rates that it can charge its customers for electric delivery service. The stipulation, which was approved by the Board of the NJBPU, provides for an electric rate increase, effective May 17, 2010, of \$9.8 million. The stipulation reflects a return on common equity of 10.3 percent and a common equity ratio of approximately 50 percent. The stipulation continues current provisions with respect to recovery from customers of the cost of purchased power and does not provide for reconciliation of actual expenses to amounts reflected in electric rates for pension and other postretirement benefit costs.

CECONY — Gas

In September 2007, the NYSPSC approved the Joint Proposal that CECONY had entered into in June 2007 with the staff of the NYSPSC and other parties with respect to the rates the company can charge its customers for gas service. The Joint Proposal had provided for rate increases of \$84.6 million, \$32.7 million and \$42.7 million, effective October 1, 2007, 2008 and 2009, respectively, along with annual funding for new energy efficiency programs of \$14 million. The NYSPSC modified the Joint Proposal to provide for levelized annual rate increases of \$67.5 million in each year of the three year rate plan.

The Joint Proposal continues the previous gas rate plan provisions with respect to recovery from customers of the cost of purchased gas and environmental remediation expenses and corresponding provisions pursuant to which the effects of weather on gas income are moderated and for the reconciliation of actual expenses allocable to the gas business to the amounts for such costs reflected in gas rates for pension and other postretirement benefit costs, property taxes and interference costs. Additional provisions of the gas rate plan include: a revenue decoupling mechanism (pursuant to which the company accrued \$24 million, \$25 million, and \$17 million of revenues in 2010, 2009, and 2008, respectively) and equal sharing with customers of earnings above a 10.7 percent return on common equity (earnings for the rate years ended September 30, 2010, 2009 and 2008 were reduced \$6 million, \$0 and \$9 million, respectively, for earnings above the 10.7 percent threshold).

In May 2010, CECONY, the staff of the NYSPSC and other parties entered into a Joint Proposal, with respect to the company's rates for gas delivery service. The Joint Proposal, which was approved by the NYSPSC in September 2010, covers the three-year period October 2010 through September 2013 and provides for gas base rate increases of \$47.1 million, \$47.9 million and \$46.7 million, effective October 2010, 2011 and 2012, respectively. The Joint Proposal reflects the following major items:

- A weighted average cost of capital of 7.46 percent, reflecting:
 - return on common equity of 9.6 percent, assuming achievement by the company of cost avoidance for productivity and "austerity". The unspecified austerity measures assume reductions in costs of \$6 million, \$4 million and \$2 million in the rate years ending September 2011, 2012 and 2013, respectively;
 - cost of long-term debt of 5.57 percent;
 - common equity ratio of 48 percent; and

Notes to the Financial Statements — Continued

- average rate base of \$3,027 million, \$3,245 million and \$3,434 million for the rate years ending September 2011, 2012 and 2013, respectively.
- Deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which actual average net plant balances allocable to the company's gas business are less than the amounts reflected in rates: \$2,934 million, \$3,148 million and \$3,346 million for the rate years ending September 2011, 2012 and 2013, respectively. No such deferral was required for the rate year ended September 2011.
- Sharing with gas customers of any actual earnings, excluding the effects of any penalties and certain other items, above specified percentage returns on equity (based on actual average common equity ratio, subject to a 50 percent maximum), on a cumulative basis over the term of the Joint Proposal, calculated as follows:
 - for the rate year ending September 2011, the company will allocate to customers the revenue requirement equivalent of 60 percent of earnings above 10.35 percent up to and including 11.59 percent, 75 percent of earnings equal to or in excess of 11.6 percent up to and including 12.59 percent and 90 percent of earnings equal to or in excess of 12.6 percent (earnings were not above 10.35 percent for the rate year ended September 2011);
 - for the rate years ending September 2012 and 2013, the company will allocate to customers the revenue requirement equivalent of 60 percent of the earnings in excess of 10.1 percent up to and including 11.59 percent, 75 percent of such earnings equal to or in excess of 11.6 percent up to and including 12.59 percent and 90 percent of such earnings equal to or in excess of 12.6 percent;
 - the customers' share of any such earnings and 50 percent of the company's share, appropriately adjusted for taxes, would be applied to reduce regulatory assets for pensions and other postretirement benefits and other costs; and
 - in the event the company does not file for a rate increase to take effect in October 2013, the earnings sharing levels for the rate year ending September 2013 will continue in effect, implemented on an annual basis, until base rates are reset by the NYSPPSC.
- Deferral as a regulatory asset or liability, as the case may be, of differences between the actual level of certain expenses, including, among others, expenses for pension and other postretirement benefits, environmental remediation, property taxes and long-term debt, and amounts for those expenses reflected in rates (with deferral for the difference in property taxes limited to 80 percent of the difference, subject to an annual maximum for the remaining 20 percent of the difference of not more than the equivalent in revenue requirement of a 10 basis point impact on return on common equity). In 2010 and 2011, the company deferred \$67 million of net regulatory assets, and \$0.3 million of net regulatory liabilities, respectively, under these provisions and the corresponding provisions of the September 2007 rate order.
- Continuation of provisions pursuant to which the company will retain net revenues from non-firm customer transactions. In each year of the rate plan, the company will retain up to \$58 million of any such revenues and 25 percent of any such revenues above \$58 million. If such revenues are below \$58 million in a rate year, the company will accrue a regulatory asset equal to (A) the amount by which such revenues are less than \$33 million plus (B) 80 percent of the difference between \$58 million and the level of such revenues at or above \$33 million. The company retained \$40 million and \$70 million of such net revenues in 2010 and 2011, respectively, under these provisions and the corresponding provisions of the September 2007 rate order.
- Continuation of the provisions pursuant to which the effects of weather on gas delivery revenues during each billing cycle are reflected in customer bills for that billing cycle, and a revenue decoupling mechanism under which the company's actual gas delivery revenues, inclusive of any such weather adjustment, would be compared, on a periodic basis, with the delivery revenues reflected in rates, with the difference accrued as a regulatory liability (for refund to gas customers) or a regulatory asset (for recovery from gas customers), as the case may be. In 2010 and 2011, the company deferred \$14 million of regulatory assets and \$20 million of regulatory liabilities, respectively, under this provision and the corresponding provisions of the September 2007 rate order.
- Continuation of the rate provisions pursuant to which the company recovers its costs of purchased gas from gas customers.

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- Continuation of provisions for potential penalties (up to \$12.6 million annually) if certain gas customer service and system performance targets are not met. In 2010 and 2011, the company did not recognize any expenses under these provisions or the corresponding provisions of the September 2007 rate order.
- Continued collection from gas customers of \$32 million on an annual basis subject to potential refund (see “Other Regulatory Matters” below and “Investigations of Vendor Payments” in Note H).

O&R — Gas

In October 2006, the NYSPSC approved the June 2006 settlement agreement among O&R, the staff of the NYSPSC and other parties. The settlement agreement established a rate plan that covered the three-year period November 1, 2006 through October 31, 2009. The rate plan provided for rate increases in base rates of \$12 million in the first year, \$0.7 million in the second year and \$1.1 million in the third year. To phase-in the effect of the increase for customers, the rate plan provided for O&R to accrue revenues for, but defer billing to customers of, \$5.5 million of the first rate year rate increase by establishing a regulatory asset which, together with interest, was billed to customers in the second and third years. As a result, O&R's billings to customers increased \$6.5 million in each of the first two years and \$6.3 million in the third. The first year rate increase included \$2.3 million relating to a change in the way customers are provided the benefit of non-firm revenue from sales of pipeline transportation capacity. Under the prior rate plan, base rates were reduced to reflect the assumption that the company would realize these revenues. Under the 2006 rate plan, such revenues were used to offset the cost of gas to be recovered from customers. The rate plan continued the provisions pursuant to which the company recovers its cost of purchasing gas and the provisions pursuant to which the effects of weather on gas income are moderated.

The rate plan provided that if the actual amount of pension or other postretirement benefit costs, environmental remediation costs, property taxes and certain other costs vary from the respective amount for each such cost reflected in gas rates (cost reconciliations), the company would defer recognition of the variation in income and, as the case may be, establish a regulatory asset or liability for recovery from, or refund to, customers of the variation (86 percent of the variation, in the case of property tax differences due to assessment changes).

Earnings attributable to its gas business excluding any revenue reductions (O&R Adjusted Earnings) in excess of an 11 percent annual return on common equity (based upon the actual average common equity ratio, subject to a maximum 50 percent of

capitalization) were to be allocated as follows: above an 11 percent return were to be used to offset up to one-half of any regulatory asset to be recorded in that year resulting from the cost reconciliations (discussed in the preceding paragraph). One-half of any remaining O&R Adjusted Earnings between 11 and 12 percent return were to be retained by the company, with the balance deferred for the benefit of customers. Thirty-five percent of any remaining O&R Adjusted Earnings between a 12 and 14 percent return were to be retained by the company, with the balance deferred for the benefit of customers. Any remaining O&R Adjusted Earnings above a 14 percent return were to be deferred for the benefit of customers. For purposes of these earnings sharing provisions, if in any rate year O&R Adjusted Earnings was less than 11 percent, the shortfall was deducted from O&R Adjusted Earnings for the other rate years. The earnings sharing thresholds were to each be reduced by 20 basis points if certain objectives relating to the company's retail choice program are not met. O&R adjusted earnings were not in excess of the 11 percent target return on equity for the rate years ended October 31, 2009, and 2008.

The rate plan also included up to \$1 million of potential earnings adjustments in the first year of the agreement, increasing up to \$1.2 million, if the company did not comply with certain requirements regarding gas main protection and customer service. O&R recorded a regulatory liability of \$0.4 million for not complying with certain requirements regarding safety and customer service for the rate year ended October 31, 2008. The company met these requirements for the rate year ended October 31, 2009.

In October 2009, the NYSPSC adopted a June 2009 Joint Proposal among O&R, NYSPSC staff and other parties. As approved, the Joint Proposal establishes a gas rate plan that covers the three-year period November 1, 2009 through October 31, 2012 and provides for increases in base rates of \$9 million in each of the first two years and \$4.6 million in the third year, with an additional \$4.3 million to be collected through a surcharge in the third rate year. The rate plan reflects the following major items:

- an annual return on common equity of 10.4 percent;
- most of any actual earnings above an 11.4 percent annual return on common equity (based upon the actual average common equity ratio, subject to a maximum 50 percent of capitalization) are to be applied to reduce regulatory assets (in 2010 and 2011, the company did not defer any revenues under this provision);
- deferral as a regulatory asset or liability, as the case may be, of differences between the actual level of

Notes to the Financial Statements — Continued

certain expenses, including expenses for pension and other postretirement benefits, environmental remediation, property taxes and taxable and tax-exempt long-term debt, and amounts for those expenses reflected in rates (in 2010 and 2011, the company deferred \$3.1 million and \$2.9 million, respectively, of expenses under this provision);

- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which average gas net plant balances are less than balances reflected in rates (in 2010 and 2011, the company deferred \$1.5 million of revenues and \$1 million of expenses, respectively, under this provision);
- deferral as a regulatory asset of increases, if any over the course of the rate plan, in certain expenses above a 4 percent annual inflation rate, but only if the actual annual return on common equity is less than 10.4 percent (in 2010 and 2011, the company did not defer any revenues under this provision);
- implementation of a revenue decoupling mechanism (in 2010 and 2011, the company accrued \$0.8 million and \$2.8 million, respectively, of revenues under this provision);
- continuation of the provisions pursuant to which the company recovers its cost of purchasing gas and the provisions pursuant to which the effects of weather on gas income are moderated; and
- potential negative earnings adjustments of up to \$1.4 million annually if certain operations and customer service requirements are not met (in 2010 and 2011, the company did not have any potential negative earnings adjustments under this provision).

CECONY — Steam

In September 2008, the NYSPSC approved the June 2008 Joint Proposal among the company, the NYSPSC staff and other parties with respect to the rates the company can charge its customers for steam service. The Joint Proposal covers the period from October 1, 2008 through September 30, 2010. The Joint Proposal provides for steam rate increases of \$43.7 million effective October 1, 2008 and 2009.

The Joint Proposal reflects the following major items:

- an annual return on common equity of 9.3 percent;
- any actual earnings above a 10.1 percent return on equity (based on actual average common equity ratio, subject to a 50 percent maximum) are to be shared as

follows: half will be deferred for the benefit of customers and the other half is to be retained by the company (with half of the company's share subject to offset to reduce any regulatory assets for under-collections of property taxes) (earnings for the rate years ended September 30, 2009 and 2010 did not exceed a 10.1 percent return on equity);

- deferral as a regulatory asset or regulatory liability, as the case may be, of the difference between (i) actual costs for pension and other postretirement benefits, environmental remediation, property taxes, certain tax-exempt debt, municipal infrastructure support and certain other costs and (ii) amounts for those costs reflected in rates (90 percent of the difference in the case of property taxes and interference costs) (the company decreased expenses by \$14.9 million and \$14.4 million and increased expenses by \$3.1 million under these provisions in 2010, 2009 and 2008, respectively);
- deferral as a regulatory liability of the revenue requirement impact (i.e., return on investment, depreciation and income taxes) of the amount, if any, by which the actual capital expenditures related to steam production plant are less than amounts reflected in rates (there was no regulatory liability recorded for the rate year ended September 30, 2009 and \$4 million regulatory liability recorded for the rate year ended September 30, 2010);
- potential negative earnings adjustments (revenue reductions) of approximately \$0.95 million to \$1 million annually if certain business development, customer service and safety performance targets are not met (the company did not record any such adjustments for the rate years ended September 30, 2010, 2009 and 2008);
- amortization of certain regulatory assets and liabilities, the net effect of which will be a non-cash increase in steam revenues of \$20.3 million over the two-year period covered by the Joint Proposal; and
- continuation of the rate provisions pursuant to which the company recovers its fuel and purchased steam costs from customers.

In May 2010, CECONY, the NYSPSC staff and other parties entered into a Joint Proposal, with respect to the company's rates for steam service. The Joint Proposal, which was approved by the NYSPSC in September 2010, covers the three-year period October 2010 through September 2013 and provides for rate increases of \$49.5 million, effective October 2010 and 2011,

Notes to the Financial Statements — Continued

and \$17.8 million, effective October 2012, with an additional \$31.7 million to be collected through a surcharge in the rate year ending September 2013. The Joint Proposal reflects the following major items:

- The same weighted average cost of capital, return on common equity (assuming, for the steam business, achievement of unspecified reductions in costs of \$4.5 million, \$3 million and \$1.5 million in the rate years ending September 2011, 2012 and 2013, respectively), cost of long-term debt and common equity ratio provided for in the May 2010 Joint Proposal with respect to CECONY's gas business (discussed above) and average steam rate base of \$1,589 million, \$1,603 million and \$1,613 million for the rate years ending September 2011, 2012 and 2013, respectively.
- Deferral as a regulatory liability of the revenue requirement impact of the amount, if any, by which actual average net plant balances allocable to the company's steam business are less than the amounts reflected in rates for the respective category for each rate year. The company deferred \$0.8 million for the rate year ended September 2011. The amounts reflected in rates are:

| (Millions of Dollars) | Rate Year Ending September 30, | | |
|-----------------------|--------------------------------|-------|-------|
| | 2011 | 2012 | 2013 |
| Steam production | \$415 | \$426 | \$433 |
| Steam distribution | 521 | 534 | 543 |

- Earnings sharing, expense deferral and potential refund (\$6 million annually for steam) provisions as discussed above with respect to CECONY's gas business. In 2011, the company did not recognize any such earnings sharing, expense deferral or potential refund.
- Continuation of the rate provisions pursuant to which the company recovers its cost of fuel and purchased steam from its steam customers.
- Continuation of provisions for potential penalties (up to approximately \$1 million annually) if certain steam customer service and system performance targets are not met. In 2011, the company did not recognize any expense under these provisions.

The NYSPSC order requires CECONY, in its next steam rate filing, to propose a phase-in over a period of not more than seven years of an increase in the allocation to steam customers of the fuel costs for the company's East River Repowering Project (ERRP, which cogenerates electricity and steam) that are above the market value of the electric energy generated by ERRP.

Other Regulatory Matters

In February 2009, the NYSPSC commenced a proceeding to examine the prudence of certain CECONY expenditures (see "Investigations of Vendor Payments" in Note H). Pursuant to NYSPSC orders, a portion of the company's revenues (currently, \$249 million, \$32 million and \$6 million on an annual basis for electric, gas and steam service, respectively) is being collected subject to potential refund to customers. At December 31, 2011, the company had collected an estimated \$816 million from customers subject to potential refund in connection with this proceeding. In October 2010, a NYSPSC consultant reported its \$21 million provisional assessment, which the company has disputed, of potential overcharges for construction work. The potential overcharges related to transactions that involved certain employees who were arrested and a contractor that performed work for the company. The NYSPSC's consultant is expected to continue to review the company's expenditures. At December 31, 2011, the company had a \$11 million regulatory liability relating to this matter. The company is unable to estimate the amount, if any, by which any refund required by the NYSPSC may exceed this regulatory liability.

In August 2009, the NYSPSC released a report on its management audit of the company. The NYSPSC is required to audit New York utilities every five years. The NYSPSC consultant that performed the audit identified areas for improvement, including with respect to the company's construction program, planning and business processes and regulatory relationships. In October 2009, the company filed with the NYSPSC the company's plan to implement the recommendations contained in the report. The company has implemented most of the recommendations.

In February 2011, the NYSPSC initiated a proceeding to examine the existing mechanisms pursuant to which utilities recover site investigation and remediation costs and possible alternatives. See Note G.

Notes to the Financial Statements – Continued

Regulatory Assets and Liabilities

Regulatory assets and liabilities at December 31, 2011 and 2010 were comprised of the following items:

| (Millions of Dollars) | Con Edison | | CECONY | |
|---|------------|---------|---------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Regulatory assets | | | | |
| Unrecognized pension and other postretirement costs | \$5,852 | \$4,371 | \$5,554 | \$4,152 |
| Future income tax | 1,798 | 1,592 | 1,724 | 1,514 |
| Environmental remediation costs | 681 | 695 | 564 | 574 |
| Pension and other post retirement benefits deferrals | 198 | 138 | 157 | 90 |
| Revenue taxes | 163 | 145 | 158 | 140 |
| Deferred storm costs | 128 | 57 | 80 | 43 |
| Net electric deferrals | 121 | 156 | 121 | 156 |
| Surcharge for New York State assessment | 90 | 121 | 82 | 112 |
| Deferred derivative losses – long-term | 60 | 74 | 44 | 48 |
| O&R transition bond charges | 44 | 48 | - | - |
| Workers' compensation | 23 | 31 | 23 | 31 |
| Recoverable energy costs – long-term | 14 | 42 | 14 | 42 |
| Property tax reconciliation | 13 | 34 | - | 26 |
| World Trade Center restoration costs | 5 | 45 | 5 | 45 |
| Other | 147 | 134 | 135 | 124 |
| Regulatory assets – long-term | 9,337 | 7,683 | 8,661 | 7,097 |
| Deferred derivative losses – current | 164 | 190 | 140 | 151 |
| Recoverable energy costs – current | - | 13 | - | - |
| Regulatory assets – current | 164 | 203 | 140 | 151 |
| Total Regulatory Assets | \$9,501 | \$7,886 | \$8,801 | \$7,248 |
| Regulatory liabilities | | | | |
| Allowance for cost of removal less salvage | \$ 448 | \$ 422 | \$ 372 | \$ 350 |
| Net unbilled revenue deferrals | 104 | 136 | 104 | 136 |
| World Trade Center settlement proceeds | 62 | - | 62 | - |
| Carrying charges on transmission and distribution net plant | 38 | 28 | 14 | 5 |
| Bonus depreciation | 35 | 1 | 34 | 1 |
| Property tax reconciliation | 35 | - | 35 | - |
| Long-term interest rate reconciliation | 30 | 13 | 30 | 13 |
| Energy efficiency programs | 22 | 12 | 20 | 11 |
| Gas line losses | 21 | - | 21 | - |
| New York State tax refund | 20 | 30 | 20 | 30 |
| Gain on sale of properties | 14 | 28 | 14 | 28 |
| Expenditure prudence proceeding | 11 | - | 11 | - |
| Other | 137 | 118 | 124 | 109 |
| Regulatory liabilities – long-term | 977 | 788 | 861 | 683 |
| Revenue decoupling mechanism | 66 | 38 | 66 | 38 |
| Refundable energy costs – current | 51 | 117 | 12 | 90 |
| Deferred derivative gains – current | 1 | 4 | 1 | 3 |
| Regulatory liabilities – current | 118 | 159 | 79 | 131 |
| Total Regulatory Liabilities | \$1,095 | \$ 947 | \$ 940 | \$ 814 |

“Unrecognized pension and other postretirement costs” represents the net regulatory asset associated with the accounting rules for retirement benefits. See Note A.

“Net electric deferrals” represents the remaining unamortized balance of certain regulatory assets and liabilities of CECONY that were combined effective April 1, 2010 and are being amortized to income over a ten year period, in accordance with CECONY’s March 2010 rate plan.

“Revenue taxes” represents the timing difference between taxes collected and paid by the Utilities to fund mass transportation.

Effective March 31, 2009, the NYSPSC authorized CECONY to accrue unbilled electric, gas and steam

Notes to the Financial Statements — Continued

revenues. At December 31, 2011, CECONY has deferred the net margin on the unbilled revenues for the future benefit of customers by recording a regulatory liability of \$104 million for the difference between the unbilled revenues and energy cost liabilities. Also, \$44 million of the regulatory asset established in 1989 for unbilled gas revenues and \$91 million of deferred World Trade Center costs has been offset against the unbilled revenue regulatory liability.

Note C — Capitalization

Common Stock

At December 31, 2011 and 2010, Con Edison owned all of the issued and outstanding shares of common stock of the Utilities and the competitive energy businesses. CECONY owns 21,976,200 shares of Con Edison stock, which it purchased prior to 2001 in connection with Con Edison's stock repurchase plan. CECONY presents in the financial statements the cost of the Con Edison stock it owns as a reduction of common shareholder's equity.

Capitalization of Con Edison

The outstanding capitalization for each of the Companies is shown on its Consolidated Statement of Capitalization, and for Con Edison includes the Utilities' outstanding preferred stock and debt.

Preferred Stock of CECONY

As of December 31, 2011, 1,915,319 shares of CECONY's \$5 Cumulative Preferred Stock (the "\$5 Preferred") and 375,626 shares of its Cumulative Preferred Stock (\$100 par value) were outstanding.

Dividends on the \$5 Preferred Stock are \$5 per share per annum, payable quarterly, and dividends on the Cumulative Preferred Stock are \$4.65 per share per annum, payable quarterly. The preferred dividends must be declared by CECONY's Board of Trustees to become payable. See "Dividends" below.

With respect to any corporate action to be taken by a vote of shareholders of CECONY, Con Edison (which owns all of the 235,488,094 shares of CECONY's common stock that are outstanding) and the holders of the \$5 Preferred are each entitled to one vote for each share held. Except as otherwise required by law, holders of the Cumulative Preferred Stock have no right to vote; provided, however, that if the \$5 Preferred is no longer outstanding, the holders of the Cumulative Preferred Stock are entitled to one vote for each share with respect to any corporate action to be taken by a vote of the shareholders of CECONY. In addition, if dividends are in arrears for certain periods, the holders are entitled to certain rights with respect to the election of CECONY's Trustees. Without the consent of the

holders of the Cumulative Preferred Stock, CECONY may not create or authorize any kind of stock ranking prior to the Cumulative Preferred Stock or, if such actions would affect the holders of the Cumulative Preferred Stock adversely, be a party to any consolidation or merger, create or amend the terms of the Cumulative Preferred Stock or reclassify the Cumulative Preferred Stock. CECONY may redeem the \$5 Preferred at a redemption price of \$105 per share and the Cumulative Preferred Stock at a redemption price of \$101 per share (in each case, plus accrued and unpaid dividends). In the event of the dissolution, liquidation or winding up of the affairs of CECONY, before any distribution of capital assets could be made to the holders of the company's common stock, the holders of the \$5 Preferred and the Cumulative Preferred Stock would each be entitled to receive \$100 per share, in the case of an involuntary liquidation, or an amount equal to the redemption price per share, in the case of a voluntary liquidation, in each case together with all accrued and unpaid dividends.

Dividends

In accordance with NYSPSC requirements, the dividends that the Utilities generally pay are limited to not more than 100 percent of their respective income available for dividends calculated on a two-year rolling average basis. Excluded from the calculation of "income available for dividends" are non-cash charges to income resulting from accounting changes or charges to income resulting from significant unanticipated events. The restriction also does not apply to dividends paid in order to transfer to Con Edison proceeds from major transactions, such as asset sales, or to dividends reducing each utility subsidiary's equity ratio to a level appropriate to its business risk. In addition, no dividends may be paid, or funds set apart for payment, on CECONY's common stock until all dividends accrued on the \$5 Preferred Stock and Cumulative Preferred Stock have been paid, or declared and set apart for payment.

Long-term Debt

Long-term debt maturing in the period 2012-2016 is as follows:

| (Millions of Dollars) | Con Edison | CECONY |
|-----------------------|------------|--------|
| 2012 | \$530 | \$525 |
| 2013 | 705 | 700 |
| 2014 | 481 | 475 |
| 2015 | 495 | 350 |
| 2016 | 731 | 650 |

The Utilities have issued \$269 million of tax-exempt debt through the New York State Energy Research and Development Authority (NYSERDA) that currently bear interest at a rate determined weekly and is subject to tender by bondholders for purchase by the Utilities. In 2010, CECONY issued \$225 million of tax-exempt debt that is subject to mandatory tender in 2012.

Notes to the Financial Statements — Continued

The carrying amounts and fair values of long-term debt are:

| (millions of dollars) | December 31, | | | |
|--|--------------------|---------------|--------------------|---------------|
| | 2011 | | 2010 | |
| Long-Term Debt (including current portion) | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Con Edison | \$ 10,673 | \$ 12,744 | \$ 10,676 | \$ 11,761 |
| CECONY | \$ 9,745 | \$ 11,593 | \$ 9,743 | \$ 10,680 |

Fair values of long-term debt have been estimated primarily using available market information.

At December 31, 2011 and 2010, long-term debt of Con Edison included \$29 million and \$32 million, respectively, of Transition Bonds issued in 2004 by O&R's New Jersey utility subsidiary through a special purpose entity.

Significant Debt Covenants

The significant debt covenants under the financing arrangements for the notes of Con Edison and the debentures of CECONY are obligations to pay principal and interest when due, covenants not to consolidate with or merge into any other corporation unless certain conditions are met and, for Con Edison's notes, covenants that Con Edison shall continue its utility business in New York City and shall not permit Con Edison's ratio of consolidated debt to consolidated capital to exceed 0.675 to 1. Con Edison's notes are also subject to cross default provisions with respect to other indebtedness of Con Edison or its material subsidiaries having a then outstanding principal balance in excess of \$100 million. CECONY's debentures have no cross default provisions. The tax-exempt financing arrangements of the Utilities are subject to covenants for the CECONY debentures discussed above and the covenants discussed below. The Companies believe that they were in compliance with their significant debt covenants at December 31, 2011.

The tax-exempt financing arrangements involved the issuance of uncollateralized promissory notes of the Utilities to NYSERDA in exchange for the net proceeds of a like amount of tax-exempt bonds with substantially the same terms sold to the public by NYSERDA. The tax-exempt financing arrangements include covenants with respect to the tax-exempt status of the financing, including covenants with respect to the use of the facilities financed. The arrangements include provisions for the maintenance of liquidity and credit facilities, the failure to comply with which would, except as otherwise provided, constitute an event of default with respect to the debt to which such provisions applied.

The failure to comply with debt covenants would, except as otherwise provided, constitute an event of default with respect to

the debt to which such provisions applied. If an event of default were to occur, the principal and accrued interest on the debt to which such event of default applied and, in the case of the Con Edison notes, a make-whole premium might and, in the case of certain events of default would, become due and payable immediately.

The liquidity and credit facilities currently in effect for the tax-exempt financing include covenants that the ratio of debt to total capital of the obligated utility will not at any time exceed 0.65 to 1 and that, subject to certain exceptions, the utility will not mortgage, lien, pledge or otherwise encumber its assets. Certain of the facilities also include as events of default, defaults in payments of other debt obligations in excess of specified levels (\$100 million for CECONY).

Note D — Short-Term Borrowing

In October 2011, Con Edison and the Utilities entered into a Credit Agreement (Credit Agreement), under which banks are committed to provide loans and letters of credit on a revolving credit basis, and terminated their Amended and Restated Credit Agreement (Prior Credit Agreement) which was to expire in June 2012. Under the Credit Agreement, which expires in October 2016, there is a maximum of \$2.25 billion of credit available, with the full amount available to CECONY and \$1 billion available to Con Edison, including up to \$1.2 billion of letters of credit. The Credit Agreement supports the Companies' commercial paper programs. The Companies have not borrowed under the Credit Agreement. At December 31, 2011 and 2010, Con Edison and CECONY had no commercial paper outstanding.

The banks' commitments under the Credit Agreement are subject to certain conditions, including that there be no event of default. The commitments are not subject to maintenance of credit rating levels or the absence of a material adverse change. Upon a change of control of, or upon an event of default by one of the Companies, the banks may terminate their commitments with respect to that company, declare any amounts owed by that company under the Credit Agreement immediately due and payable and require that company to provide cash collateral relating to the letters of credit issued for it under the Credit Agreement. Events of default include the exceeding at any time of a ratio of consolidated debt to consolidated total capital of 0.65 to 1 (at December 31, 2011 this ratio was 0.48 to 1 for Con Edison and CECONY); having liens on its assets in an aggregate amount exceeding 5 percent of its consolidated total capital, subject to certain exceptions; and the failure, following any applicable notice period, to meet certain other customary covenants. Interest and fees charged for the revolving credit facilities and any loans made or letters of credit issued under the Credit Agreement reflect the Companies' respective credit ratings.

Notes to the Financial Statements — Continued

At December 31, 2011 and 2010, \$173 million (including \$150 million for CECONY) and \$197 million (including \$145 million for CECONY) of letters of credit were outstanding under the Credit Agreement and Prior Credit Agreement, respectively.

See Note S for information about short-term borrowing between related parties.

Note E — Pension Benefits

Con Edison maintains a tax-qualified, non-contributory pension plan that covers substantially all employees of CECONY and O&R and certain employees of Con Edison's competitive energy businesses. The plan is designed to comply with the Internal Revenue Code and the Employee Retirement Income Security Act of 1974. In addition, Con Edison maintains additional non-qualified supplemental pension plans.

Net Periodic Benefit Cost

The components of the Companies' net periodic benefit costs for 2011, 2010, and 2009 were as follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|------------|--------|--------|--------|--------|--------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| Service cost – including administrative expenses | \$ 190 | \$ 168 | \$ 159 | \$ 177 | \$ 157 | \$ 149 |
| Interest cost on projected benefit obligation | 560 | 556 | 525 | 524 | 521 | 492 |
| Expected return on plan assets | (734) | (704) | (691) | (698) | (670) | (659) |
| Amortization of net actuarial loss | 530 | 425 | 299 | 501 | 401 | 271 |
| Amortization of prior service costs | 8 | 8 | 8 | 6 | 6 | 7 |
| NET PERIODIC BENEFIT COST | \$ 554 | \$ 453 | \$ 300 | \$ 510 | \$ 415 | \$ 260 |
| Amortization of regulatory asset* | 2 | 2 | 3 | 2 | 2 | 3 |
| TOTAL PERIODIC BENEFIT COST | \$ 556 | \$ 455 | \$ 303 | \$ 512 | \$ 417 | \$ 263 |
| Cost capitalized | (185) | (157) | (109) | (172) | (146) | (98) |
| Cost deferred | (65) | (115) | (38) | (68) | (113) | (32) |
| Cost charged to operating expenses | \$ 306 | \$ 183 | \$ 156 | \$ 272 | \$ 158 | \$ 133 |

* Relates to an increase in CECONY's pension obligation of \$45 million from a 1999 special retirement program.

Notes to the Financial Statements — Continued

Funded Status

The funded status at December 31, 2011, 2010, and 2009 was as follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|-------------------|-------------------|------------------|-------------------|------------------|------------------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| CHANGE IN PROJECTED BENEFIT OBLIGATION | | | | | | |
| Projected benefit obligation at beginning of year | \$10,307 | \$ 9,408 | \$ 9,383 | \$ 9,653 | \$ 8,803 | \$ 8,793 |
| Service cost – excluding administrative expenses | 186 | 160 | 158 | 174 | 149 | 147 |
| Interest cost on projected benefit obligation | 560 | 556 | 525 | 524 | 521 | 492 |
| Plan amendments | - | 6 | 5 | - | - | - |
| Net actuarial (gain)/loss | 1,251 | 636 | (215) | 1,166 | 607 | (216) |
| Benefits paid | (479) | (459) | (448) | (445) | (427) | (413) |
| PROJECTED BENEFIT OBLIGATION AT END OF YEAR | \$11,825 | \$10,307 | \$ 9,408 | \$11,072 | \$ 9,653 | \$ 8,803 |
| CHANGE IN PLAN ASSETS | | | | | | |
| Fair value of plan assets at beginning of year | \$ 7,721 | \$ 6,877 | \$ 5,836 | \$ 7,340 | \$ 6,544 | \$ 5,562 |
| Actual return on plan assets | 37 | 888 | 1,220 | 33 | 846 | 1,166 |
| Employer contributions | 542 | 443 | 291 | 498 | 404 | 249 |
| Benefits paid | (479) | (459) | (448) | (445) | (427) | (413) |
| Administrative expenses | (21) | (28) | (22) | (20) | (27) | (20) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | \$ 7,800 | \$ 7,721 | \$ 6,877 | \$ 7,406 | \$ 7,340 | \$ 6,544 |
| FUNDED STATUS | \$ (4,025) | \$ (2,586) | \$(2,531) | \$ (3,666) | \$(2,313) | \$(2,259) |
| Unrecognized net loss | 5,351 | 3,915 | 3,868 | 5,063 | 3,716 | 3,666 |
| Unrecognized prior service costs | 30 | 38 | 40 | 16 | 22 | 28 |
| Accumulated benefit obligation | 10,595 | 9,319 | 8,598 | 9,876 | 8,694 | 8,015 |

The increase in the pension plan's projected benefit obligation was a primary driver in the increased pension liability at Con Edison and CECONY of \$1,439 million and \$1,353 million, respectively, compared with December 31, 2010. For Con Edison, this increase in pension liability resulted in an increase to regulatory assets of \$1,402 million for unrecognized net losses and unrecognized prior service costs associated with the Utilities consistent with the accounting rules for regulated operations and a debit to OCI of \$15 million (net of taxes) for the unrecognized net losses and unrecognized prior service costs associated with the competitive energy businesses and O&R's New Jersey and Pennsylvania utility subsidiaries.

For CECONY, the increase in pension liability resulted in an increase to regulatory assets of \$1,338 million for unrecognized net losses and unrecognized prior service costs consistent with the accounting rules for regulated operations associated with the Utilities and a debit to OCI of \$2 million for unrecognized net losses and unrecognized prior service costs associated with the competitive energy businesses.

A portion of the estimated net loss and prior service cost for the pension plan, equal to \$703 million and \$8 million, respectively, will be amortized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for Con Edison. Included in these amounts are \$665 million and \$6 million, respectively, for CECONY.

At December 31, 2011 and 2010, Con Edison's investments include \$129 million and \$119 million, respectively, held in external trust accounts for benefit payments pursuant to the supplemental retirement plans. Included in these amounts for CECONY were \$120 million and \$109 million, respectively. See Note P. The accumulated benefit obligations for the supplemental retirement plans for Con Edison and CECONY were \$208 million and \$171 million as of December 31, 2011 and \$192 million and \$158 million as of December 31, 2010, respectively.

Notes to the Financial Statements — Continued

Assumptions

The actuarial assumptions were as follows:

| | 2011 | 2010 | 2009 |
|---|-------|-------|-------|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount rate | 4.70% | 5.60% | 6.05% |
| Rate of compensation increase | | | |
| – CECONY | 4.35% | 4.35% | 4.00% |
| – O&R | 4.25% | 4.25% | 4.00% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount rate | 5.60% | 6.05% | 5.75% |
| Expected return on plan assets | 8.50% | 8.50% | 8.50% |
| Rate of compensation increase | | | |
| – CECONY | 4.35% | 4.00% | 4.00% |
| – O&R | 4.25% | 4.00% | 4.00% |

The expected return assumption reflects anticipated returns on the plan's current and future assets. The Companies' expected return was based on an evaluation of the current environment, market and economic outlook, relationships between the economy and asset class performance patterns, and recent and long-term trends in asset class performance. The projections were based on the plan's target asset allocation.

Discount Rate Assumption

To determine the assumed discount rate, the Companies use a model that produces a yield curve based on yields on selected highly rated (Aaa or Aa, by Moody's Investors Service) corporate bonds. Bonds with insufficient liquidity, bonds with questionable pricing information and bonds that are not representative of the overall market are excluded from consideration. For example, the bonds used in the model cannot be callable, they must have a price between 50 and 200, the yield must lie between 1 percent and 20 percent, and the amount of the issue must be in excess of \$100 million. The spot rates defined by the yield curve and the plan's projected benefit payments are used to develop a weighted average discount rate.

Expected Benefit Payments

Based on current assumptions, the Companies expect to make the following benefit payments over the next ten years:

| (Millions of Dollars) | 2012 | 2013 | 2014 | 2015 | 2016 | 2017-2021 |
|-----------------------|-------|-------|-------|-------|-------|-----------|
| Con Edison | \$525 | \$552 | \$579 | \$604 | \$629 | \$3,487 |
| CECONY | 489 | 515 | 539 | 563 | 586 | 3,253 |

Expected Contributions

Based on estimates as of December 31, 2011, the Companies expect to make contributions to the pension plan during 2012 of \$759 million (of which \$707 million is to be contributed by CECONY). The Companies' policy is to fund their accounting cost to the extent tax deductible.

Plan Assets

The asset allocations for the pension plan at the end of 2011, 2010, and 2009, and the target allocation for 2012 are as follows:

| Asset Category | Target | Plan Assets at December 31 | | | |
|-------------------|------------------|----------------------------|------|------|------|
| | Allocation Range | 2012 | 2011 | 2010 | 2009 |
| Equity | | | | | |
| – Securities | 55% - 65% | 61% | 67% | 67% | 67% |
| – Debt Securities | 27% - 33% | 32% | 28% | 28% | 28% |
| – Real Estate | 8% - 12% | 7% | 5% | 5% | 5% |
| Total | 100% | 100% | 100% | 100% | 100% |

Con Edison has established a pension trust for the investment of assets to be used for the exclusive purpose of providing retirement benefits to participants and beneficiaries and payment of plan expenses.

Pursuant to resolutions adopted by Con Edison's Board of Directors, the Management Development and Compensation Committee of the Board of Directors (the Committee) has general oversight responsibility for Con Edison's pension and other employee benefit plans. The pension plan's named fiduciaries have been granted the authority to control and manage the operation and administration of the plans, including overall responsibility for the investment of assets in the trust and the power to appoint and terminate investment managers.

The investment objectives of the Con Edison pension plan are to maintain a level and form of assets adequate to meet benefit obligations to participants, to achieve the expected long-term total return on the trust assets within a prudent level of risk and maintain a level of volatility that is not expected to have a material impact on the Company's expected contribution and expense or the Company's ability to meet plan obligations. The assets of the plan have no significant concentration of risk in one country (other than the United States), industry or entity.

The strategic asset allocation is intended to meet the objectives of the pension plan by diversifying its funds across asset classes, investment styles and fund managers. An asset/liability study typically is conducted every few years to determine whether the current strategic asset allocation continues to represent the

Notes to the Financial Statements — Continued

appropriate balance of expected risk and reward for the plan to meet expected liabilities. Each study considers the investment risk of the asset allocation and determines the optimal asset allocation for the plan. The target asset allocation for 2012 reflects the results of such a study conducted in 2011.

Individual fund managers operate under written guidelines provided by Con Edison, which cover such areas as investment objectives, performance measurement, permissible investments, investment restrictions, trading and execution, and communication and reporting requirements. Con Edison management regularly monitors, and the named fiduciaries review and report to the Committee regarding, asset class performance, total fund performance, and compliance with asset allocation guidelines. Management changes fund managers and rebalances the portfolio as appropriate. At the

direction of the named fiduciaries, such changes are reported to the Committee.

Assets measured at fair value on a recurring basis are summarized below under a three-level hierarchy established by the accounting rules which define the levels within the hierarchy as follows:

- Level 1 – Consists of fair value measurements whose value is based on quoted prices in active markets for identical assets or liabilities.
- Level 2 – Consists of fair value measurements whose value is based on significant other observable inputs.
- Level 3 – Consists of fair value measurements whose value is based on significant unobservable inputs.

The fair values of the pension plan assets at December 31, 2011 by asset category are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|----------------|----------------|--------------|----------------|
| U.S. Equity(a) | \$2,506 | \$ - | \$ - | \$2,506 |
| International Equity(b) | 1,904 | 637 | - | 2,541 |
| U.S. Government Issues(c) | - | 1,618 | - | 1,618 |
| Corporate Bonds(d) | - | 668 | 94 | 762 |
| Structured Assets(e) | - | - | 13 | 13 |
| Other Fixed Income(f) | - | 67 | 29 | 96 |
| Real Estate(g) | - | - | 572 | 572 |
| Cash and Cash Equivalents(h) | 13 | 395 | - | 408 |
| Total investments | \$4,423 | \$3,385 | \$708 | \$8,516 |
| Funds for retiree health benefits(i) | (174) | (134) | (28) | (336) |
| Investments (excluding funds for retiree health benefits) | \$4,249 | \$3,251 | \$680 | \$8,180 |
| Pending activities(j) | | | | (380) |
| Total fair value of plan net assets | | | | \$7,800 |

(a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and actively-managed small-capitalization equities.

(b) International Equity includes international equity index funds and actively-managed international equities.

(c) U.S. Government Issues include agency and treasury securities.

(d) Corporate Bonds classified as Level 3 include 144A illiquid securities.

(e) Structured Assets are measured using broker quotes and investment manager proprietary models and include commercial-mortgage-backed securities and collateralized mortgage obligations.

(f) Other Fixed Income includes municipal bonds, sovereign debt and regional governments.

(g) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.

(h) Cash and Cash Equivalents include short term investments, money markets, foreign currency and cash collateral.

(i) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Companies' other postretirement benefit obligation. See Note F.

(j) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received and reflects adjustments for available estimates at year end.

Notes to the Financial Statements — Continued

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2011 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2011 | Assets Still Held at Reporting Date – Unrealized Gains/ (Losses) | Assets Sold During the Period—Realized Gains | Purchases Sales and Settlements | Ending Balance as of December 31, 2011 |
|---|---|--|--|---------------------------------|--|
| Corporate Bonds | \$129 | \$ (9) | \$11 | \$ (37) | \$ 94 |
| Structured Assets | 87 | (1) | 2 | (75) | 13 |
| Other Fixed Income | 66 | (1) | 3 | (39) | 29 |
| Real Estate | 398 | 65 | - | 109 | 572 |
| Total investments | \$680 | \$54 | \$16 | \$ (42) | \$708 |
| Funds for retiree health benefits | (30) | 3 | 1 | (2) | (28) |
| Investments (excluding funds for retiree health benefits) | \$650 | \$57 | \$17 | \$ (44) | \$680 |

The fair values of the pension plan assets at December 31, 2010 by asset category are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|---------|
| U.S. Equity(a) | \$3,935 | \$ - | \$ - | \$3,935 |
| International Equity(b) | 1,249 | 234 | - | 1,483 |
| U.S. Government Issues(c) | - | 1,300 | - | 1,300 |
| Corporate Bonds(d) | - | 571 | 129 | 700 |
| Structured Assets(e) | - | - | 87 | 87 |
| Other Fixed Income(f) | - | 31 | 66 | 97 |
| Real Estate(g) | - | - | 398 | 398 |
| Cash and Cash Equivalents(h) | 3 | 232 | - | 235 |
| Total investments | \$5,187 | \$2,368 | \$680 | \$8,235 |
| Funds for retiree health benefits(i) | (226) | (103) | (30) | (359) |
| Investments (excluding funds for retiree health benefits) | \$4,961 | \$2,265 | \$650 | \$7,876 |
| Pending activities(j) | | | | (155) |
| Total fair value of plan net assets | | | | \$7,721 |

(a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds, actively-managed small-capitalization equities, rights and warrants.

(b) International Equity includes international equity index funds, actively-managed international equities, rights and warrants.

(c) U.S. Government Issues include agency and treasury securities.

(d) Corporate Bonds held in institutional mutual funds which are measured at Net Asset Value (NAV) are classified as Level 3.

(e) Structured Assets are measured using broker quotes and investment manager proprietary models and include commercial-mortgage-backed securities, collateralized mortgage obligations and asset-backed securities.

(f) Other Fixed Income includes emerging market debt valued using broker quotes, municipal bonds, sovereign debt, regional governments and government agencies.

(g) Real Estate investments include real estate funds based on appraised values that are broadly diversified by geography and property type.

(h) Cash and Cash Equivalents include short term investments, money markets and foreign currency.

(i) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Companies' other postretirement benefit obligation. See Note F.

(j) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received and reflects adjustments for available estimates at year end.

Notes to the Financial Statements — Continued

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2010 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2010 | Assets Still Held at Reporting Date – Unrealized Gains/(Losses) | Assets Sold During the Period – Realized Gains/(Losses) | Purchases Sales and Settlements | Ending Balance as of December 31, 2010 |
|---|---|---|---|---------------------------------|--|
| U.S. Equity | \$ - | \$ - | \$ - | \$ - | \$ - |
| International Equity | 1 | 1 | (1) | (1) | - |
| Corporate Bonds | 143 | (3) | 9 | (20) | 129 |
| Structured Assets | 91 | 15 | (6) | (13) | 87 |
| Other Fixed Income | 46 | - | 2 | 18 | 66 |
| Swaps | (3) | 2 | (1) | 2 | - |
| Real Estate | 344 | 47 | - | 7 | 398 |
| Total investments | \$622 | 62 | 3 | (7) | \$680 |
| Funds for retiree health benefits | (28) | (3) | (2) | 3 | (30) |
| Investments (excluding funds for retiree health benefits) | \$594 | \$59 | \$ 1 | \$ (4) | \$650 |

The Companies also offer a defined contribution savings plan that covers substantially all employees and made contributions to the plan as follows:

| (Millions of Dollars) | For the Years Ended December 31 | | |
|-----------------------|---------------------------------|------|------|
| | 2011 | 2010 | 2009 |
| Con Edison | \$23 | \$19 | \$19 |
| CECONY | 21 | 17 | 17 |

Note F — Other Postretirement Benefits

The Utilities currently have contributory comprehensive hospital, medical and prescription drug programs for all retirees, their dependents and surviving spouses.

CECONY also has a contributory life insurance program for bargaining unit employees and provides basic life insurance benefits up to a specified maximum at no cost to retired management employees. O&R has a non-contributory life insurance program for retirees. Certain employees of Con Edison's competitive energy businesses are eligible to receive benefits under these programs.

Net Periodic Benefit Cost

The components of the Companies' net periodic postretirement benefit costs for 2011, 2010, and 2009 were as follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|------------|-------|-------|--------|-------|-------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| Service cost | \$ 26 | \$ 24 | \$ 22 | \$ 20 | \$ 19 | \$ 18 |
| Interest cost on accumulated other postretirement benefit obligation | 83 | 91 | 95 | 72 | 80 | 84 |
| Expected return on plan assets | (88) | (86) | (86) | (78) | (78) | (78) |
| Amortization of net actuarial loss | 88 | 92 | 74 | 80 | 85 | 65 |
| Amortization of prior service cost | (10) | (12) | (12) | (11) | (14) | (14) |
| Amortization of transition obligation | 4 | 3 | 3 | 4 | 3 | 3 |
| NET PERIODIC POSTRETIREMENT BENEFIT COST | \$103 | \$112 | \$ 96 | \$ 87 | \$ 95 | \$ 78 |
| Cost capitalized | (35) | (39) | (35) | (29) | (33) | (29) |
| Cost charged | 14 | 4 | 3 | 13 | 1 | 1 |
| Cost charged to operating expenses | \$ 82 | \$ 77 | \$ 64 | \$ 71 | \$ 63 | \$ 50 |

Notes to the Financial Statements — Continued

Funded Status

The funded status of the programs at December 31, 2011, 2010, and 2009 were as follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| CHANGE IN BENEFIT OBLIGATION | | | | | | |
| Benefit obligation at beginning of year | \$1,642 | \$1,697 | \$1,702 | \$1,426 | \$1,495 | \$1,495 |
| Service cost | 25 | 24 | 22 | 20 | 19 | 18 |
| Interest cost on accumulated postretirement benefit obligation | 83 | 91 | 95 | 72 | 80 | 84 |
| Net actuarial loss/(gain) | 109 | (68) | (14) | 86 | (77) | (3) |
| Benefits paid and administrative expenses | (144) | (138) | (141) | (132) | (126) | (130) |
| Participant contributions | 33 | 29 | 26 | 32 | 28 | 25 |
| Medicare prescription benefit | 8 | 7 | 7 | 7 | 7 | 6 |
| BENEFIT OBLIGATION AT END OF YEAR | \$1,756 | \$1,642 | \$1,697 | \$1,511 | \$1,426 | \$1,495 |
| CHANGE IN PLAN ASSETS | | | | | | |
| Fair value of plan assets at beginning of year | \$ 942 | \$ 866 | \$ 737 | \$ 839 | \$ 777 | \$ 668 |
| Actual return on plan assets | 20 | 89 | 153 | 19 | 78 | 137 |
| Employer contributions | 84 | 96 | 86 | 74 | 85 | 73 |
| Participant contributions | 33 | 29 | 26 | 32 | 28 | 25 |
| Benefits paid | (132) | (138) | (136) | (124) | (129) | (126) |
| FAIR VALUE OF PLAN ASSETS AT END OF YEAR | \$ 947 | \$ 942 | \$ 866 | \$ 840 | \$ 839 | \$ 777 |
| FUNDED STATUS | \$ (809) | \$ (700) | \$ (831) | \$ (671) | \$ (587) | \$ (718) |
| Unrecognized net loss | 563 | 483 | 646 | 496 | 601 | 728 |
| Unrecognized prior service costs | (1) | (10) | (23) | (15) | (40) | (54) |
| Unrecognized net transition liability at January 1, 1993 | 4 | 7 | 11 | 4 | 11 | 15 |

The increase in the value of other postretirement benefit plan obligation was a primary driver in the increased liability for other postretirement benefits at Con Edison and CECONY of \$109 million and \$84 million respectively, compared with December 31, 2010. For Con Edison, this increased liability resulted in an increase to regulatory assets of \$79 million for unrecognized net losses and unrecognized prior service costs associated with the Utilities consistent with the accounting rules for regulated operations and a debit to OCI of \$3 million (net of taxes) for the unrecognized net losses and unrecognized prior service costs associated with the competitive energy businesses and O&R's New Jersey and Pennsylvania utility subsidiaries.

For CECONY, the increase in liability resulted in an increase to regulatory assets of \$64 million for unrecognized net losses and unrecognized prior service costs associated with the company consistent with the accounting rules for regulated operations and an immaterial change to OCI for unrecognized net losses and unrecognized prior service costs associated with the competitive energy businesses.

A portion of the estimated net loss, prior service costs and transition obligation for the other postretirement benefits, equal to \$97 million, \$(6) million and \$4 million, respectively, will be

amortized from accumulated OCI and the regulatory asset into net periodic benefit cost over the next year for Con Edison. Included in these amounts are \$86 million, \$(8) million and \$4 million, respectively, for CECONY.

Assumptions

The actuarial assumptions were as follows:

| | 2011 | 2010 | 2009 |
|---|-------|-------|-------|
| Weighted-average assumptions used to determine benefit obligations at December 31: | | | |
| Discount Rate | 4.55% | 5.40% | 5.95% |
| Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31: | | | |
| Discount Rate | 5.40% | 5.95% | 5.75% |
| Expected Return on Plan Assets | | | |
| Tax-Exempt | 8.50% | 8.50% | 8.50% |
| Taxable | | | |
| CECONY | 7.50% | 7.50% | 7.50% |
| O&R | 8.00% | 8.00% | 8.00% |

Notes to the Financial Statements — Continued

Refer to Note E for descriptions of the basis for determining the expected return on assets, investment policies and strategies, and the assumed discount rate.

The health care cost trend rate used to determine net periodic benefit cost for the year ended December 31, 2011 was 6.0 percent, which is assumed to decrease gradually to 4.5 percent by 2014 and remain at that level thereafter. The health care cost trend rate used to determine benefit obligations as of December 31, 2011 was 6.0 percent, which is assumed to decrease gradually to 4.5 percent by 2018 and remain at that level thereafter.

A one-percentage point change in the assumed health care cost trend rate would have the following effects at December 31, 2012:

| | Con Edison | | CECONY | |
|---|--------------------------------|----------|----------|----------|
| | 1-Percentage-Point | | | |
| | (Millions of Dollars) Increase | Decrease | Increase | Decrease |
| Effect on accumulated other postretirement benefit obligation | \$8 | \$(5) | \$(25) | \$22 |
| Effect on service cost and interest cost components for 2011 | 1 | (1) | (1) | 1 |

Expected Benefit Payments

Based on current assumptions, the Companies expect to make the following benefit payments over the next ten years:

| (Millions of Dollars) | 2012 | 2013 | 2014 | 2015 | 2016 | 2017-2021 |
|---|-------|-------|-------|-------|-------|-----------|
| GROSS BENEFIT PAYMENTS | | | | | | |
| Con Edison | \$122 | \$124 | \$126 | \$128 | \$128 | \$640 |
| CECONY | 110 | 112 | 113 | 114 | 114 | 559 |
| MEDICARE PRESCRIPTION BENEFIT RECEIPTS | | | | | | |
| Con Edison | \$ 12 | \$ 13 | \$ 14 | \$ 15 | \$ 16 | \$ 94 |
| CECONY | 11 | 12 | 13 | 14 | 14 | 85 |

Expected Contributions

Based on estimates as of December 31, 2011, Con Edison expects to make a contribution of \$100 million, including \$86 million for CECONY, to the other postretirement benefit plans in 2012.

Con Edison has established postretirement health and life insurance benefit plan trusts for the investment of assets to be used for the exclusive purpose of providing other postretirement benefits to participants and beneficiaries.

Plan Assets

The asset allocations for CECONY's other postretirement benefit plans at the end of 2011, 2010, and 2009, and the target allocation for 2012 are as follows:

| Asset Category | Target Allocation Range | Plan Assets at December 31 | | |
|-------------------|-------------------------|----------------------------|------|------|
| | | 2012 | 2011 | 2010 |
| Equity Securities | 57% - 73% | 62% | 67% | 66% |
| Debt Securities | 26% - 44% | 38% | 33% | 34% |
| Total | 100% | 100% | 100% | 100% |

Refer to Note E for a discussion of Con Edison's investment policy for its benefit plans.

Notes to the Financial Statements — Continued

The fair values of the plan assets at December 31, 2011 by asset category (see description of levels in Note E) are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|-------|
| U.S. Equity(a) | \$115 | \$162 | \$ - | \$277 |
| International Equity(b) | - | 104 | - | 104 |
| Other Fixed Income(c) | - | 207 | - | 207 |
| Cash and Cash Equivalents(d) | - | 18 | - | 18 |
| Total investments | \$115 | \$491 | \$ - | \$606 |
| Funds for retiree health benefits(e) | 174 | 134 | 28 | 336 |
| Investments (including funds for retiree health benefits) | \$289 | \$625 | \$28 | \$942 |
| Pending activities(f) | | | | 5 |
| Total fair value of plan net assets | | | | \$947 |

(a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and commingled funds.

(b) International Equity includes commingled international equity funds.

(c) Other Fixed Income includes commingled funds, which are valued at Net Asset Value (NAV).

(d) Cash and Cash Equivalents include short term investments and money markets.

(e) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Companies' other postretirement benefit obligation. See Note E.

(f) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received, and reflects adjustments for available estimates at year end.

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2011 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2011 | Assets Still Held at Reporting Date – Unrealized Gains (Losses) | Assets Sold During the Period – Realized (Losses) | Purchases Sales and Settlements | Transfers Out of Level 3 | Ending Balance as of December 31, 2011 |
|---|---|---|---|---------------------------------|--------------------------|--|
| Other Fixed Income | \$189 | \$ - | \$ - | \$ - | \$(189) | \$ - |
| Insurance Contracts | - | - | - | - | - | - |
| Total investments | \$189 | - | - | - | (189) | \$ - |
| Funds for retiree health benefits | 30 | (3) | (1) | 2 | - | 28 |
| Investments (including funds for retiree health benefits) | \$219 | \$(3) | \$(1) | \$2 | \$(189) | \$28 |

The fair values of the plan assets at December 31, 2010 by asset category (see description of levels in Note E) are as follows:

| (Millions of Dollars) | Level 1 | Level 2 | Level 3 | Total |
|---|---------|---------|---------|-------|
| U.S. Equity(a) | \$118 | \$172 | \$ - | \$290 |
| International Equity(b) | - | 107 | - | 107 |
| Other Fixed Income(c) | - | - | 189 | 189 |
| Cash and Cash Equivalents(d) | - | 11 | - | 11 |
| Total investments | \$118 | \$290 | \$189 | \$597 |
| Funds for retiree health benefits(e) | 226 | 103 | 30 | 359 |
| Investments (including funds for retiree health benefits) | \$344 | \$393 | \$219 | \$956 |
| Pending activities(f) | | | | (14) |
| Total fair value of plan net assets | | | | \$942 |

(a) U.S. Equity includes both actively- and passively-managed assets with investments in domestic equity index funds and commingled funds.

(b) International Equity includes commingled international equity funds.

(c) Other Fixed Income includes commingled funds, which are valued at Net Asset Value (NAV).

(d) Cash and Cash Equivalents include short term investments and money markets.

(e) The Companies set aside funds for retiree health benefits through a separate account within the pension trust, as permitted under Section 401(h) of the Internal Revenue Code of 1986, as amended. In accordance with the Code, the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees. The net assets held in the 401(h) account are calculated based on a pro-rata percentage allocation of the net assets in the pension plan. The related obligations for health benefits are not included in the pension plan's obligations and are included in the Companies' other postretirement benefit obligation. See Note E.

(f) Pending activities include security purchases and sales that have not settled, interest and dividends that have not been received, and reflects adjustments for available estimates at year end.

Notes to the Financial Statements — Continued

The table below provides a reconciliation of the beginning and ending net balances for assets at December 31, 2010 classified as Level 3 in the fair value hierarchy.

| (Millions of Dollars) | Beginning Balance as of January 1, 2010 | Assets Still Held at Reporting Date — Unrealized Gains/(Losses) | Assets Sold During the Period — Realized Gains/(Losses) | Purchases Sales and Settlements | Ending Balance as of December 31, 2010 |
|--|---|---|---|---------------------------------------|--|
| Other Fixed Income | \$173 | \$11 | \$ 1 | \$ 4 | \$189 |
| Insurance Contracts | 8 | - | (1) | (7) | - |
| Total investments | \$181 | \$11 | \$ - | \$(3) | \$189 |
| Funds for retiree health benefits | 28 | 3 | 2 | (3) | 30 |
| Investments (including funds for retiree health benefits) | \$209 | \$14 | \$ 2 | \$(6) | \$219 |

Effect of Medicare Prescription Benefit

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 created a benefit for certain employers who provide postretirement drug programs. The accounting rules for retirement benefits provide accounting and disclosure requirements relating to the Act. The Companies' actuaries have determined that each of their prescription drug plans provides a benefit that is at least actuarially equivalent to the Medicare prescription drug plan and projections indicate that this will be the case for 20 years; therefore, the Companies are eligible to receive the benefit that the Act makes available. When the plans' benefits are no longer actuarially equivalent to the Medicare plan, 25 percent of the retirees in each plan are assumed to begin to decline participation in the Companies' prescription programs.

In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 became law. In the first half of 2010, the Companies reduced their deferred tax asset to reflect the laws' repeal, effective 2013, of the deduction for federal income tax purposes of the portion of the cost of an employer's retiree prescription drug coverage for which the employer received a benefit under the Medicare Prescription Drug Improvement and Modernization Act of 2003. For CECONY, the reductions in its deferred tax asset of \$33 million had no effect on net income because a regulatory asset in a like amount on a pre-tax basis was established to reflect future recovery from customers of the increased cost of its retiree prescription drug coverage resulting from the loss of the tax deduction. For O&R's New York electric and gas services the reductions in their deferred tax assets of \$3 million had no effect on net income because a regulatory asset in a like amount on a pre-tax basis was established to reflect future recovery from customers of the increased cost of their retiree prescription drug coverage resulting from the loss of the tax deduction. For RECO and Pike County Light & Power

Company, the reduction in their deferred tax assets of \$1 million was taken as a charge to net income. The impact on Con Edison's deferred tax assets for its other businesses was not material to its results of operations.

Note G — Environmental Matters Superfund Sites

Hazardous substances, such as asbestos, polychlorinated biphenyls (PCBs) and coal tar, have been used or generated in the course of operations of the Utilities and their predecessors and are present at sites and in facilities and equipment they currently or previously owned, including sites at which gas was manufactured or stored.

The Federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state statutes (Superfund) impose joint and several liability, regardless of fault, upon generators of hazardous substances for investigation and remediation costs (which include costs of demolition, removal, disposal, storage, replacement, containment, and monitoring) and natural resource damages. Liability under these laws can be material and may be imposed for contamination from past acts, even though such past acts may have been lawful at the time they occurred. The sites at which the Utilities have been asserted to have liability under these laws, including their manufactured gas plant sites and any neighboring areas to which contamination may have migrated, are referred to herein as "Superfund Sites."

For Superfund Sites where there are other potentially responsible parties and the Utilities are not managing the site investigation and remediation, the accrued liability represents an estimate of the amount the Utilities will need to pay to investigate and, where determinable, discharge their related obligations. For Superfund Sites (including the manufactured gas plant sites) for which one of the Utilities is managing the

Notes to the Financial Statements — Continued

investigation and remediation, the accrued liability represents an estimate of the company's share of undiscounted cost to investigate the sites and, for sites that have been investigated in whole or in part, the cost to remediate the sites, if remediation is necessary and if a reasonable estimate of such cost can be made. Remediation costs are estimated in light of the information available, applicable remediation standards, and experience with similar sites.

The accrued liabilities and regulatory assets related to Superfund Sites at December 31, 2011 and 2010 were as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|------------------------------|------------|-------|--------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Accrued Liabilities: | | | | |
| Manufactured gas plant sites | \$422 | \$446 | \$307 | \$327 |
| Other Superfund Sites | 67 | 66 | 66 | 65 |
| Total | \$489 | \$512 | \$373 | \$392 |
| Regulatory assets | \$681 | \$695 | \$564 | \$574 |

Most of the accrued Superfund Site liability relates to sites that have been investigated, in whole or in part. However, for some of the sites, the extent and associated cost of the required remediation has not yet been determined. As investigations progress and information pertaining to the required remediation becomes available, the Utilities expect that additional liability may be accrued, the amount of which is not presently determinable but may be material. Under their current rate agreements, the Utilities are permitted to recover or defer as regulatory assets (for subsequent recovery through rates) certain site investigation and remediation costs. In February 2011, the NYSPSC initiated a proceeding to examine the existing mechanisms pursuant to which utilities recover such costs and possible alternatives.

Environmental remediation costs incurred and insurance recoveries received related to Superfund Sites at December 31, 2011 and 2010 were as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|--------------------------------|------------|------|--------|------|
| | 2011 | 2010 | 2011 | 2010 |
| Remediation costs incurred | \$39 | \$39 | \$35 | \$36 |
| Insurance recoveries received* | - | 1 | - | 1 |

* Reduced amount deferred for recovery from customers

In 2010, CECONY estimated that for its manufactured gas plant sites, its aggregate undiscounted potential liability for the investigation and remediation of coal tar and/or other manufactured gas plant-related environmental contaminants could range up to \$1.9 billion. In 2010, O&R estimated that for its manufactured gas plant sites, each of which has been

investigated, the aggregate undiscounted potential liability for the remediation of such contaminants could range up to \$200 million. These estimates were based on the assumption that there is contamination at all sites, including those that have not yet been fully investigated and additional assumptions about the extent of the contamination and the type and extent of the remediation that may be required. Actual experience may be materially different.

Asbestos Proceedings

Suits have been brought in New York State and federal courts against the Utilities and many other defendants, wherein a large number of plaintiffs sought large amounts of compensatory and punitive damages for deaths and injuries allegedly caused by exposure to asbestos at various premises of the Utilities. The suits that have been resolved, which are many, have been resolved without any payment by the Utilities, or for amounts that were not, in the aggregate, material to them. The amounts specified in all the remaining thousands of suits total billions of dollars; however, the Utilities believe that these amounts are greatly exaggerated, based on the disposition of previous claims. In 2010, CECONY estimated that its aggregate undiscounted potential liability for these suits and additional suits that may be brought over the next 15 years is \$10 million. The estimate was based upon a combination of modeling, historical data analysis and risk factor assessment. Actual experience may be materially different. In addition, certain current and former employees have claimed or are claiming workers' compensation benefits based on alleged disability from exposure to asbestos. Under its current rate agreements, CECONY is permitted to defer as regulatory assets (for subsequent recovery through rates) costs incurred for its asbestos lawsuits and workers' compensation claims. The accrued liability for asbestos suits and workers' compensation proceedings (including those related to asbestos exposure) and the amounts deferred as regulatory assets for the Companies at December 31, 2011 and 2010 were as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|---|------------|-------|--------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Accrued liability – asbestos suits | \$10 | \$ 10 | \$10 | \$ 10 |
| Regulatory assets – asbestos suits | \$10 | \$ 10 | \$10 | \$ 10 |
| Accrued liability – workers' compensation | \$98 | \$106 | \$93 | \$101 |
| Regulatory assets – workers' compensation | \$23 | \$ 31 | \$23 | \$ 31 |

Note H — Other Material Contingencies Manhattan Steam Main Rupture

In July 2007, a CECONY steam main located in midtown Manhattan ruptured. It has been reported that one person died and others were injured as a result of the incident. Several buildings in the area were damaged. Debris from the incident

Notes to the Financial Statements — Continued

included dirt and mud containing asbestos. The response to the incident required the closing of several buildings and streets for various periods. Approximately 93 suits are pending against the company seeking generally unspecified compensatory and, in some cases, punitive damages, for personal injury, property damage and business interruption. The company has not accrued a liability for the suits. The company has notified its insurers of the incident and believes that the policies in force at the time of the incident will cover most of the company's costs, which the company is unable to estimate, but which could be substantial, to satisfy its liability to others in connection with the incident.

Investigations of Vendor Payments

In January 2009, CECONY commenced an internal investigation relating to the arrests of certain employees and retired employees (all of whom have since been convicted) for accepting kickbacks from contractors that performed construction work for the company. The company has retained a law firm, which has retained an accounting firm, to assist in the company's investigation. The company has provided information to governmental authorities, which consider the company to be a victim of unlawful conduct, in connection with their investigation of the arrested employees and contractors. The company has terminated its employment of the arrested employees and its contracts with the contractors. In February 2009, the NYSPSC commenced a proceeding that, among other things, will examine the prudence of certain of the company's expenditures relating to the arrests and consider whether additional expenditures should also be examined (see "Other Regulatory Matters" in Note B).

CECONY is also investigating the September 2010 arrest of a retired employee (who has since been convicted of participating in a bribery scheme in which the employee received payments from two companies that supplied materials to the company) and the January 2011 arrest of an employee (for accepting kickbacks from an engineering firm that performed work for the company). CECONY has provided information to governmental authorities in connection with their ongoing investigations of these matters.

The company, based upon its evaluation of its internal controls for 2011 and previous years, believes that the controls were effective to provide reasonable assurance that its financial statements have been fairly presented, in all material respects, in conformity with generally accepted accounting principles. Because the company's investigations are ongoing, the company is unable to predict the impact of any of the employees' unlawful conduct on the company's internal controls, business, results of operations or financial position.

Other Contingencies

See "Lease In/Lease Out Transactions" in Note J.

Guarantees

Con Edison and its subsidiaries enter into various agreements providing financial or performance assurance primarily to third parties on behalf of their subsidiaries. Maximum amounts guaranteed by Con Edison totaled \$760 million and \$859 million at December 31, 2011 and 2010, respectively.

A summary, by type and term, of Con Edison's total guarantees at December 31, 2011 is as follows:

| Guarantee Type | 0 – 3 | 4 – 10 | > 10 | Total |
|--------------------------|-----------------------|--------|-------|-------|
| | years | years | years | |
| | (Millions of Dollars) | | | |
| Energy transactions | \$640 | \$ 3 | \$63 | \$706 |
| Intra-company guarantees | 15 | - | 1 | 16 |
| Other guarantees | 25 | 13 | - | 38 |
| TOTAL | \$680 | \$16 | \$64 | \$760 |

Energy Transactions — Con Edison guarantees payments on behalf of its competitive energy businesses in order to facilitate physical and financial transactions in gas, pipeline capacity, transportation, oil, electricity and energy services. To the extent that liabilities exist under the contracts subject to these guarantees, such liabilities are included in Con Edison's consolidated balance sheet.

Intra-company Guarantees — Con Edison guarantees electricity sales made by Con Edison Energy and Con Edison Solutions to O&R and CECONY.

Other Guarantees — Con Edison also guarantees the following:

- \$13 million relates to guarantees issued by Con Edison to CECONY covering a former Con Edison subsidiary's lease payment to use CECONY's conduit system in accordance with a tariff approved by the NYSPSC and a guarantee issued by Con Edison to a landlord to guarantee the former subsidiary's obligations under a building lease. The former subsidiary is obligated to reimburse Con Edison for any payments made under these guarantees. This obligation is fully secured by letters of credit;
- \$25 million for guarantees provided by Con Edison to Travelers Insurance Company for indemnity agreements for surety bonds in connection with energy service projects performed by Con Edison Solutions; and

Notes to the Financial Statements — Continued

- Con Edison, on behalf of Con Edison Solutions, as a retail electric provider, issued a guarantee to the Public Utility Commission of Texas with no specified limitation on the amount guaranteed, covering the

payment of all obligations of a retail electric provider. Con Edison's estimate of the maximum potential obligation is \$5 million as of December 31, 2011.

Note I — Electricity Purchase Agreements

CECONY has long-term electricity purchase agreements with non-utility generators and others for generating capacity. The company recovers its purchased power costs in accordance with provisions approved by the NYSPSC. See "Recoverable Energy Costs" in Note A.

At December 31, 2011, the significant terms of the electricity purchase agreements were as follows:

| Facility | Equity Owner | Plant Output (MW) | Contracted Output (MW) | Contract Start Date | Contract Term (Years) |
|---------------------|--|-------------------|------------------------|---------------------|-----------------------|
| Indian Point | Entergy Nuclear Power Marketing, LLC | 1,299 | 350* | August 2001 | 16 |
| Independence | Sithe/Independence Power Partners, LP | 1,254 | 691 | November 1994 | 20 |
| Linden Cogeneration | Cogen Technologies Linden Venture, LP | 1,035 | 624 | May 1992 | 25 |
| Astoria Energy | Astoria Energy, LLC | 640 | 500 | May 2006 | 10 |
| Selkirk | Selkirk Cogen Partners, LP | 446 | 265 | September 1994 | 20 |
| Brooklyn Navy Yard | Brooklyn Navy Yard Cogeneration Partners, LP | 322 | 274 | November 1996 | 40 |
| Indeck Corinth | Indeck Energy Services of Corinth, Inc. | 147 | 131 | July 1995 | 20 |

* Contracted output will increase to 500 MW in 2013.

Assuming performance by the parties to the electricity purchase agreements, CECONY is obligated over the terms of the agreements to make capacity and other fixed payments.

For the years 2012 through 2016, the capacity and other fixed payments under the contracts are estimated to be as follows:

| (Millions of Dollars) | 2012 | 2013 | 2014 | 2015 | 2016 |
|-----------------------|-------|-------|-------|-------|-------|
| CECONY | \$492 | \$491 | \$433 | \$221 | \$158 |

For energy delivered under most of the electricity purchase agreements, CECONY is obligated to pay variable prices. The company's payments under the agreements for capacity, energy and other fixed payments in 2011, 2010, and 2009 were as follows:

| (Millions of Dollars) | For the Years Ended December 31, | | |
|-----------------------|----------------------------------|---------|---------|
| | 2011 | 2010 | 2009 |
| Linden Cogeneration | \$ 379 | \$ 414 | \$ 395 |
| Indian Point | 238 | 524 | 620 |
| Astoria Energy | 225 | 223 | 192 |
| Selkirk | 209 | 185 | 175 |
| Brooklyn Navy Yard | 123 | 123 | 124 |
| Independence | 121 | 119 | 122 |
| Indeck Corinth | 77 | 68 | 68 |
| Wheelabrator | - | - | 10 |
| Total | \$1,372 | \$1,656 | \$1,706 |

Note J — Leases

Con Edison's subsidiaries lease electric generating and gas distribution facilities, other electric transmission and distribution facilities, office buildings and equipment. In accordance with the accounting rules for leases, these leases are classified as either capital leases, operating leases or leveraged leases. Most of the operating leases provide the option to renew at the fair rental value for future periods. Generally, it is expected that leases will be renewed or replaced in the normal course of business.

Notes to the Financial Statements — Continued

Capital leases: For ratemaking purposes capital leases are treated as operating leases; therefore, in accordance with the accounting rules for regulated operations, the amortization of the leased asset is based on the rental payments recovered from customers. The following assets under capital leases are included in the Companies' consolidated balance sheets at December 31, 2011 and 2010:

| (Millions of Dollars) | Con Edison | | CECONY | |
|-----------------------|------------|------|--------|------|
| | 2011 | 2010 | 2011 | 2010 |
| UTILITY PLANT | | | | |
| Transmission | \$1 | \$ 2 | \$1 | \$ 2 |
| Common | 8 | 11 | 6 | 11 |
| TOTAL | \$9 | \$13 | \$7 | \$13 |

The accumulated amortization of the capital leases for Con Edison and CECONY was \$66 million and \$65 million, respectively at December 31, 2011, and \$59 million each at December 31, 2010.

The future minimum lease commitments for the above assets are as follows:

| (Millions of Dollars) | Con Edison | CECONY |
|--|------------|--------|
| 2012 | \$6 | \$6 |
| 2013 | - | - |
| 2014 | 1 | 1 |
| 2015 | 1 | 1 |
| 2016 | - | - |
| All years thereafter | 1 | 1 |
| Total | 9 | 9 |
| Less: amount representing interest | 2 | 2 |
| Present value of net minimum lease payment | \$7 | \$7 |

CECONY subleases one of its capital leases. The minimum rental to be received in the future under the non-cancelable sublease is \$3 million.

Operating leases: The future minimum lease commitments under the Companies' non-cancelable operating lease agreements are as follows:

| (Millions of Dollars) | Con Edison | CECONY |
|-----------------------|------------|--------|
| 2012 | \$ 50 | \$ 47 |
| 2013 | 52 | 49 |
| 2014 | 45 | 43 |
| 2015 | 14 | 11 |
| 2016 | 13 | 10 |
| All years thereafter | 89 | 77 |
| Total | \$263 | \$237 |

Lease In/Lease Out Transactions

In each of 1997 and 1999, Con Edison Development entered into a transaction in which it leased property and then immediately subleased it back to the lessor (termed "Lease In/Lease Out," or LILLO transactions). The transactions respectively involve electric generating and gas distribution facilities in the Netherlands, with a total investment of \$259 million. The transactions were financed with \$93 million of equity and \$166 million of non-recourse, long-term debt secured by the underlying assets. In accordance with the accounting rules for leases, Con Edison is accounting for the two LILLO transactions as leveraged leases. Accordingly, the company's investment in these leases, net of non-recourse debt, is carried as a single amount in Con Edison's consolidated balance sheet and income is recognized pursuant to a method that incorporates a level rate of return for those years when net investment in the lease is positive, based upon the after-tax cash flows projected at the inception of the leveraged leases. The company's investment in these leveraged leases was \$(55) million at December 31, 2011 and \$(41) million at December 31, 2010 and is comprised of a \$234 million gross investment less \$289 million of deferred tax liabilities at December 31, 2011 and \$235 million gross investment less \$276 million of deferred tax liabilities at December 31, 2010.

On audit of Con Edison's tax return for 1997, the IRS disallowed the tax losses in connection with the 1997 LILLO transaction. In December 2005, Con Edison paid a \$0.3 million income tax deficiency asserted by the IRS for the tax year 1997 with respect to the 1997 LILLO transaction. In April 2006, the company paid interest of \$0.2 million associated with the deficiency and commenced an action in the United States Court of Federal Claims, entitled Consolidated Edison Company of New York, Inc. v. United States, to obtain a refund of this tax payment and interest. A trial was completed in November 2007. In October 2009, the court issued a decision in favor of the company concluding that the 1997 LILLO transaction was, in substance, a true lease that possessed economic substance, the loans relating to the lease constituted bona fide indebtedness, and the deductions for the 1997 LILLO transactions claimed by the company in its 1997 federal income tax return are allowable. The IRS appealed the decision in December 2011.

In connection with its audit of Con Edison's federal income tax returns for 1998 through 2007, the IRS disallowed \$416 million of net tax deductions taken with respect to both of the LILLO transactions for the tax years. Con Edison is pursuing administrative appeals of these audit level disallowances. In connection with its audit of Con Edison's federal income tax returns for 2010, 2009 and 2008, the IRS has disallowed \$40 million, \$41 million and \$42 million, respectively, of net tax deductions taken with respect to both of the LILLO transactions.

Notes to the Financial Statements — Continued

When these audit level disallowances become appealable, Con Edison intends to file an appeal of the disallowances.

Con Edison believes that its LILO transactions have been correctly reported, and has not recorded any reserve with respect to the disallowance of tax losses, or related interest, in connection with its LILO transactions. Con Edison's estimated tax savings, reflected in its financial statements, from the two LILO transactions through December 31, 2011, in the aggregate, was \$236 million. If Con Edison were required to repay all or a portion of these amounts, it would also be required to pay interest of up to \$111 million net of tax at December 31, 2011.

Pursuant to the accounting rules for leveraged lease transactions, the expected timing of income tax cash flows generated by Con Edison's LILO transactions are required to be reviewed at least annually. If the expected timing of the cash

flows is revised, the rate of return and the allocation of income would be recalculated from the inception of the LILO transactions, and the company would be required to recalculate the accounting effect of the LILO transactions, which would result in a charge to earnings that could have a material adverse effect on the company's results of operations.

Note K — Goodwill

In 2011 and 2010, Con Edison completed impairment tests for its goodwill of \$406 million related to the O&R merger, and determined that it was not impaired. For the impairment test, \$245 million and \$161 million of the goodwill were allocated to CECONY and O&R, respectively. In 2011 and 2010, Con Edison completed impairment tests for the goodwill of \$23 million related to two energy services companies acquired by Con Edison Solutions and an interest in a gas storage company acquired by Con Edison Development, and determined that the goodwill was not impaired.

Note L — Income Tax

The components of income tax are as follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|---|--------------|---------------|--------------|--------------|---------------|--------------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| State | | | | | | |
| Current | \$ 56 | \$ 23 | \$ (12) | \$ 53 | \$ 13 | \$ (1) |
| Deferred | 63 | 106 | 118 | 55 | 100 | 103 |
| Federal | | | | | | |
| Current | 53 | (144) | 16 | 43 | (139) | 42 |
| Deferred | 434 | 569 | 324 | 413 | 527 | 266 |
| Amortization of investment tax credits | (6) | (6) | (6) | (6) | (6) | (6) |
| TOTAL CHARGE TO INCOME TAX EXPENSE | \$600 | \$ 548 | \$440 | \$558 | \$ 495 | \$404 |

Notes to the Financial Statements – Continued

The tax effects of temporary differences, which gave rise to deferred tax assets and liabilities, are as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|---|------------|---------|----------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Deferred tax liabilities: | | | | |
| Depreciation | \$ 3,699 | \$3,083 | \$ 3,464 | \$2,915 |
| Regulatory asset – future income tax | 1,971 | 1,760 | 1,891 | 1,666 |
| Unrecognized pension and other postretirement costs | 2,554 | 1,775 | 2,255 | 1,686 |
| State income tax | 892 | 759 | 811 | 677 |
| Capitalized overheads | 536 | 508 | 470 | 444 |
| Pension | 682 | 625 | 709 | 638 |
| Investment tax credits | 55 | 61 | 52 | 58 |
| Other | 696 | 720 | 467 | 448 |
| Total deferred tax liabilities | 11,085 | 9,291 | 10,119 | 8,532 |
| Deferred tax assets: | | | | |
| Unrecognized pension and other postretirement costs | 2,554 | 1,775 | 2,255 | 1,686 |
| Regulatory liability – future income tax | 173 | 168 | 167 | 152 |
| Other | 1,061 | 741 | 933 | 623 |
| Total deferred tax assets | 3,788 | 2,684 | 3,355 | 2,461 |
| NET DEFERRED TAX LIABILITIES AND INVESTMENT TAX CREDITS | \$ 7,297 | \$6,607 | \$ 6,764 | \$6,071 |
| DEFERRED TAX LIABILITIES AND INVESTMENT TAX CREDITS – Non current | \$ 7,563 | \$6,769 | \$ 6,921 | \$6,202 |
| DEFERRED TAX ASSETS – Current | (266) | (162) | (157) | (131) |
| TOTAL DEFERRED TAX LIABILITIES AND INVESTMENT TAX CREDITS | \$ 7,297 | \$6,607 | \$ 6,764 | \$6,071 |

Reconciliation of the difference between income tax expense and the amount computed by applying the prevailing statutory income tax rate to income before income taxes is as follows:

| (% of Pre-tax income) | Con Edison | | | CECONY | | |
|---|------------|------|------|--------|------|------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| STATUTORY TAX RATE | | | | | | |
| Federal | 35% | 35% | 35% | 35% | 35% | 35% |
| Changes in computed taxes resulting from: | | | | | | |
| State income tax | 5 | 5 | 5 | 5 | 5 | 6 |
| Depreciation related differences | - | - | 1 | - | - | 1 |
| Cost of removal | (4) | (4) | (5) | (4) | (4) | (6) |
| Other | - | (1) | (3) | - | (1) | (2) |
| Effective Tax Rate | 36% | 35% | 33% | 36% | 35% | 34% |

For federal income tax purposes, Con Edison has a net operating loss carryforward available from 2011 of \$484 million, primarily as a result of accelerated depreciation, which if unused will expire in 2031. Con Edison has recorded a deferred tax asset for its loss carryforward, and no valuation allowance has been provided, as it is more likely than not that the deferred tax asset will be realized. Con Edison had a 2010 net operating loss for federal income tax purposes. In 2011, Con Edison received a refund using the 2010 net operating loss to offset a prior year's taxable income.

For New York State income tax purposes, Con Edison has a net operating loss carryforward available from 2009 of \$220 million, primarily as a result of repair allowance deductions discussed below. A deferred tax asset has been recognized for this New York State net operating loss that will not expire until 2029. A valuation allowance has not been provided; as it is more likely than not that the deferred tax asset will be realized.

Notes to the Financial Statements — Continued

Uncertain Tax Positions

Under the accounting rules for income taxes, an enterprise shall not recognize the tax benefit attributable to a tax position unless such position is more likely than not to be sustained upon examination by taxing authorities, including resolution of any related appeals and litigation processes, based solely on the technical merits of the position.

The IRS has essentially completed its field audits of the Con Edison's federal income tax returns through 2010. Con Edison's federal income tax returns for 1998 through 2010 reflect certain tax positions with which the IRS does not or may not agree. Any adjustments to federal income tax returns would result in changes to Con Edison's New York state income tax returns. In addition, Con Edison's New York state income tax returns for years beginning with 2006 remain open for examination.

The Companies' 2010 and 2009 federal income tax returns reflect, among other things, an incremental current deduction

for the costs of certain repairs to utility plant (the "repair allowance deductions"). Prior to 2009, Con Edison capitalized such costs and included these costs in depreciation expense in its federal income tax returns. At December 31, 2011, with respect to the repair allowance deductions, Con Edison recorded a liability for uncertain tax positions of \$88 million (\$85 million attributable to CECONY).

In August 2011, the IRS issued guidance regarding the use and evaluation of statistical samples and sampling estimates. This guidance provides a safe harbor method of determining whether certain expenditures for electric transmission and distribution property can be currently deducted for federal income tax purposes. No guidance was issued related to generation, gas, or steam property. At December 31, 2011, the Companies' estimated liabilities for uncertain tax positions reflect their anticipated adoption of the new IRS guidance, which did not have a material impact on net income.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits for Con Edison and CECONY follows:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|------------|-------|-------|--------|-------|-------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| Balance at the beginning of the year | \$ 93 | \$ 86 | \$118 | \$ 79 | \$ 92 | \$108 |
| Additions based on tax positions related to the current year | 76 | 5 | - | 74 | 4 | - |
| Additions based on tax positions of prior years | 4 | 67 | 3 | 3 | 49 | 1 |
| Reductions for tax positions of prior years | (43) | (4) | (21) | (42) | (4) | (5) |
| Settlements | - | (61) | (14) | - | (62) | (12) |
| Balance at the end of the year | \$130 | \$ 93 | \$ 86 | \$114 | \$ 79 | \$ 92 |

At December 31, 2011, the Companies' estimated liabilities for uncertain tax positions (\$130 million for Con Edison and \$114 million for CECONY) were classified on their respective consolidated balance sheets either as current liabilities (\$67 million for Con Edison and \$53 million for CECONY) or as a reduction to current deferred tax assets (\$63 million for Con Edison and \$62 million for CECONY). The Companies reasonably expect to resolve these uncertain tax positions with the IRS in the next 12 months.

The Companies recognize interest accrued related to the liability for uncertain tax positions in interest expense and would

recognize penalties, if any, in operating expenses in the Companies' consolidated income statements. In 2011, 2010 and 2009, the Companies recognized an immaterial amount of interest and no penalties for uncertain tax positions in their consolidated income statements. At December 31, 2011 and 2010, the Companies recognized an immaterial amount of interest and no penalties in their consolidated balance sheets.

At December 31, 2011, the total amount of unrecognized tax benefits that, if recognized, would affect the Companies' effective tax rate is \$11 million (\$5 million attributable to CECONY).

Notes to the Financial Statements — Continued

Note M — Stock-Based Compensation

The Companies may compensate employees and directors with, among other things, stock options, restricted stock units and contributions to a discount stock purchase plan. The Stock Option Plan provided for awards of stock options to officers and employees for up to 10 million shares of Con Edison common stock. The Long Term Incentive Plan (LTIP), among other things, provides for awards of restricted stock units, stock options and, to Con Edison's non-officer directors, deferred stock units for up to 10 million shares of common stock (of which not more than four million shares may be restricted stock or stock units).

Shares of Con Edison common stock used to satisfy the Companies' obligations with respect to stock-based compensation may be new (authorized, but unissued) shares, treasury shares or shares purchased in the open market. The shares used during the period ended December 31, 2011 were treasury shares and new shares. The shares used during the period ended December 31, 2010 were new shares.

Under the accounting rules for stock compensation, the Companies have recognized the cost of stock-based compensation as an expense using a fair value measurement method. The following table summarizes stock-based compensation expense recognized by the Companies in the period ended December 31, 2011, 2010, and 2009:

| (Millions of Dollars) | Con Edison | | | CECONY | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| Restricted stock units | \$ 3 | \$ 1 | \$ 1 | \$ 3 | \$ 1 | \$ 1 |
| Performance-based restricted stock | 48 | 27 | 20 | 44 | 25 | 19 |
| Non-officer director deferred stock compensation | 1 | 1 | 1 | 1 | 1 | 1 |
| Total | \$52 | \$29 | \$22 | \$48 | \$27 | \$21 |
| Income Tax Benefit | \$21 | \$12 | \$ 9 | \$20 | \$11 | \$ 9 |

Stock Options

The Companies last issued stock options in 2006. The stock options generally vested over a three-year period and have a term of ten years. Options were granted at an exercise price equal to the fair market value of a common share when the option was granted. The Companies generally recognized compensation expense (based on the fair value of stock option awards) over the continuous service period in which the options vested. Awards to employees eligible for retirement were expensed in the month awarded.

The outstanding options are "equity awards" because shares of Con Edison common stock are delivered upon exercise of the options. As equity awards, the fair value of the options is measured at the grant date. There were no options granted in 2011 and 2010.

A summary of changes in the status of stock options awarded as of December 31, 2011 is as follows:

| | Con Edison | | CECONY | |
|-------------------------|-------------|---------------------------------|-------------|---------------------------------|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at 12/31/10 | 2,935,250 | \$43.588 | 2,406,700 | \$43.652 |
| Exercised | (1,999,975) | 43.844 | (1,656,575) | 43.924 |
| Forfeited | (8,250) | 42.253 | (9,250) | 41.766 |
| Outstanding at 12/31/11 | 927,025 | \$43.046 | 740,875 | \$43.066 |

The changes in the fair value of all outstanding options from their grant dates to December 31, 2011 and 2010 (aggregate intrinsic value) for Con Edison were \$18 million. The changes in the fair value of all outstanding options from their grant dates to December 31, 2011 and 2010 (aggregate intrinsic value) for CECONY were \$14 million. The aggregate intrinsic value of options exercised in 2011 and 2010 were \$21 million and \$15 million, respectively, and the cash received by Con Edison for payment of the exercise price was \$88 million and \$100 million, respectively. The weighted average remaining contractual life of options outstanding is three years as of December 31, 2011.

Notes to the Financial Statements — Continued

The following table summarizes stock options outstanding at December 31, 2011 for each plan year for the Companies:

| Plan Year | Con Edison | | | CECONY | |
|-----------|----------------------------|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
| | Remaining Contractual Life | Options Outstanding/ Exercisable | Weighted Average Exercise Price | Options Outstanding/ Exercisable | Weighted Average Exercise Price |
| 2006 | 4 | 323,950 | \$44.178 | 266,250 | \$44.211 |
| 2005 | 3 | 239,975 | 42.328 | 195,975 | 42.361 |
| 2004 | 2 | 216,600 | 44.018 | 161,650 | 44.029 |
| 2003 | 1 | 82,450 | 38.555 | 65,450 | 38.577 |
| 2002 | 1 | 64,050 | 42.510 | 51,550 | 42.510 |
| Total | | 927,025 | \$43.046 | 740,875 | \$43.066 |

The income tax benefit Con Edison realized from stock options exercised in the period ended December 31, 2011 and 2010 was \$2 million and \$6 million, respectively. The income tax benefit Con Edison realized from stock options exercised in the period end December 31, 2009 was immaterial.

Restricted Stock Units

Restricted stock unit awards under the LTIP have been made as follows: (i) to officers and certain employees, including awards that provide for adjustment of the number of units (performance-restricted stock units or Performance RSUs); and (ii) in connection with the directors' deferred compensation plan. Each restricted stock unit awarded represents the right to receive, upon vesting, one share of Con Edison common stock, or, except for units awarded under the directors' plan, the cash value of a share or a combination thereof.

In accordance with the accounting rules for stock compensation, for outstanding restricted stock awards other than Performance RSUs or awards under the directors' deferred compensation plan, the Companies have accrued a liability based on the market value of a common share on the grant date and are recognizing compensation expense over the vesting period. The vesting period for awards is three years and is based on the employee's continuous service to Con Edison. Prior to vesting, the awards are subject to forfeiture in whole or in part under certain circumstances. The awards are "liability awards" because each restricted stock unit represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, prior to vesting, changes in the fair value of the units are reflected in net income. A summary of changes in the status of restricted stock (other than Performance RSUs or awards

under the directors' deferred compensation plan) during the period ended December 31, 2011 is as follows:

| | Con Edison | | CECONY | |
|------------------------|------------|--|----------|--|
| | Units | Weighted Average Grant Date Fair Value | Units | Weighted Average Grant Date Fair Value |
| Non-vested at 12/31/10 | 66,359 | \$41.334 | 62,959 | \$41.332 |
| Granted | 22,620 | 50.720 | 21,420 | 50.720 |
| Vested | (21,403) | 39.705 | (20,353) | 39.706 |
| Forfeited | (2,156) | 43.276 | (2,106) | 43.246 |
| Non-vested at 12/31/11 | 65,420 | \$45.049 | 61,920 | \$45.049 |

The total expense to be recognized by the Companies in future periods for unvested awards outstanding as of December 31, 2011 for Con Edison and CECONY was \$2 million and is expected to be recognized over a weighted average period of one year.

The number of units in each annual Performance RSU award is subject to adjustment as follows: (i) 50 percent of the units awarded will be multiplied by a factor that may range from 0 to 150 percent based on Con Edison's total shareholder return relative to a specified peer group during a specified performance period (the TSR portion); and (ii) 50 percent of the units awarded will be multiplied by a factor that may range from 0 to 200 percent based on determinations made in connection with CECONY's Executive Incentive Plan, or, for certain officers, the O&R Annual Team Incentive Plan or goals relating to Con Edison's competitive energy businesses (the EIP portion). Units generally vest when the performance period ends.

Notes to the Financial Statements — Continued

For the TSR portion of Performance RSU, the Companies use a Monte Carlo simulation model to estimate the fair value of the awards. The fair value is recomputed each reporting period as of the earlier of the reporting date and the vesting date. For the EIP portion of Performance RSU, the fair value of the awards is determined using the market price as of the earlier of the reporting date or the vesting date multiplied by the average EIP determination over the vesting period. Performance RSU awards are “liability awards” because each Performance RSU represents the right to receive, upon vesting, one share of Con Edison common stock, the cash value of a share or a combination thereof. As such, changes in the fair value of the Performance RSUs are reflected in net income. The following table illustrates the assumptions used to calculate the fair value of the awards:

| | 2011 |
|-------------------------|---------------|
| Risk-free interest rate | 0.12% - 3.73% |
| Expected term | 3 years |
| Expected volatility | 16.37% |

The risk-free rate is based on the U.S. Treasury zero-coupon yield curve on the date of grant. The expected term of the Performance RSUs is three years, which equals the vesting period. The Companies do not expect significant forfeitures to occur. The expected volatility is calculated using daily closing stock prices over a period of three years, which approximates the expected term of the awards.

A summary of changes in the status of the Performance RSUs TSR portion during the period ended December 31, 2011 is as follows:

| | Con Edison | | CECONY | |
|------------------------|-------------------|--|---------------|--|
| | Units | Weighted Average Grant Date Fair Value* | Units | Weighted Average Grant Date Fair Value* |
| Non-vested at 12/31/10 | 494,188 | \$37.844 | 407,861 | \$37.755 |
| Granted | 217,735 | 43.847 | 177,077 | 43.923 |
| Vested | (210,763) | 33.256 | (174,712) | 33.070 |
| Forfeited | (26,643) | 40.083 | (22,847) | 40.205 |
| Non-vested at 12/31/11 | 474,517 | \$42.511 | 387,379 | \$42.542 |

* Fair value is determined using the Monte Carlo simulation described above. Weighted average grant date fair value does not reflect any accrual or payment of dividends prior to vesting.

A summary of changes in the status of the Performance RSUs' EIP portion during the period ended December 31, 2011 is as follows:

| | Con Edison | | CECONY | |
|------------------------|-------------------|--|---------------|--|
| | Units | Weighted Average Grant Date Fair Value* | Units | Weighted Average Grant Date Fair Value* |
| Non-vested at 12/31/10 | 494,188 | \$42.591 | 407,861 | \$42.525 |
| Granted | 217,735 | 50.053 | 177,077 | 50.073 |
| Vested | (210,763) | 40.926 | (174,712) | 40.894 |
| Forfeited | (26,643) | 44.288 | (22,847) | 44.415 |
| Non-vested at 12/31/11 | 474,517 | \$46.660 | 387,379 | \$46.599 |

* Fair value is determined using the market price of one share of Con Edison common stock on the grant date. The market price has not been discounted to reflect that dividends do not accrue and are not payable on Performance RSUs until vesting.

The total expense to be recognized by Con Edison in future periods for unvested Performance RSUs outstanding as of December 31, 2011 is \$37 million, including \$30 million for CECONY and is expected to be recognized over a weighted average period of two years for both Con Edison and CECONY.

Con Edison has a deferred stock compensation plan for non-officer directors. Awards under the deferred compensation stock plan are covered by the LTIP. Each director received 1,687 stock units in 2011 for service as a director. These stock units are deferred until the director's termination of service. Directors may elect to receive dividend equivalents earned on stock units in cash payments. Restricted stock units issued under the directors' deferred compensation plan are considered “equity awards,” because they may only be settled in shares. Directors immediately vest in units issued to them. The fair value of the units is determined using the closing price of Con Edison's common stock on the business day immediately preceding the date of issue. In the period ended December 31, 2011, approximately 28,497 units were issued at a weighted average grant date price of \$54.06.

Stock Purchase Plan

The Stock Purchase Plan provides for the Companies to contribute up to \$1 for each \$9 invested by their directors, officers or employees to purchase Con Edison common stock under the plan. Eligible participants may invest up to \$25,000 during any calendar year (subject to an additional limitation for officers and employees of not more than 20% of their pay). Dividends paid on shares held under the plan are reinvested in additional shares unless otherwise directed by the participant.

Notes to the Financial Statements — Continued

Participants in the plan immediately vest in shares purchased by them under the plan. The fair value of the shares of Con Edison common stock purchased under the plan was calculated using the average of the high and low composite sale prices at which shares were traded at the New York Stock Exchange on the trading day immediately preceding such purchase dates. During 2011, 2010, and 2009, 721,520, 738,951, and 868,622 shares were purchased under the Stock Purchase Plan at a weighted average price of \$52.50, \$45.52, and \$38.15 per share, respectively.

Note N — Financial Information by Business Segment

The business segments of each of the Companies, which are its operating segments, were determined based on management's reporting and decision-making requirements in accordance with the accounting rules for segment reporting.

Con Edison's principal business segments are CECONY's regulated utility activities, O&P's regulated utility activities and Con Edison's competitive energy businesses. CECONY's principal business segments are its regulated electric, gas and steam utility activities.

All revenues of these business segments, excluding revenues earned by Con Edison Development on certain energy infrastructure projects, which are deemed to be immaterial, are from customers located in the United States of America. Also, all assets of the business segments, excluding certain investments in energy infrastructure projects by Con Edison Development (\$234 million at December 31, 2011), are located in the United States of America. The accounting policies of the segments are the same as those described in Note A.

Common services shared by the business segments are assigned directly or allocated based on various cost factors, depending on the nature of the service provided.

Notes to the Financial Statements — Continued

The financial data for the business segments are as follows:

| As of and for the Year Ended December 31, 2011 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
|---|-------------------------------|-----------------------------------|--|-----------------------------|-----------------------------|-----------------------------------|--------------------------|--------------------------------------|
| CECONY | | | | | | | | |
| Electric | \$ 8,280 | \$ 12 | \$656 | \$1,695 | \$414 | \$481 | \$27,123 | \$1,354 |
| Gas | 1,521 | 5 | 110 | 295 | 78 | 43 | 5,518 | 335 |
| Steam | 683 | 79 | 63 | 93 | 42 | 43 | 2,577 | 89 |
| Consolidation adjustments | - | (96) | - | - | - | - | - | - |
| Total CECONY | \$10,484 | \$ - | \$829 | \$2,083 | \$534 | \$567 | \$35,218 | \$1,778 |
| O&R | | | | | | | | |
| Electric | \$ 641 | \$ - | \$ 35 | \$ 81 | \$ 20 | \$ 21 | \$ 1,755 | \$ 79 |
| Gas | 214 | - | 13 | 33 | 12 | 9 | 722 | 32 |
| Other* | - | - | - | - | 2 | - | 8 | - |
| Total O&R | \$ 855 | \$ - | \$ 48 | \$ 114 | \$ 34 | \$ 30 | \$ 2,485 | \$ 111 |
| Competitive energy businesses | \$ 1,617 | \$ 13 | \$ 7 | \$ 46 | \$ (1) | \$ 20 | \$ 856 | \$ 114 |
| Other** | (18) | (13) | - | (4) | 27 | - | 655 | - |
| Total Con Edison | \$12,938 | \$ - | \$884 | \$2,239 | \$594 | \$617 | \$39,214 | \$2,003 |
| As of and for the Year Ended December 31, 2010 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
| CECONY | | | | | | | | |
| Electric | \$ 8,376 | \$ 12 | \$623 | \$1,549 | \$424 | \$371 | \$25,045 | \$1,421 |
| Gas | 1,541 | 5 | 102 | 310 | 82 | 91 | 5,095 | 334 |
| Steam | 656 | 74 | 62 | 63 | 43 | 29 | 2,465 | 111 |
| Consolidation adjustments | - | (91) | - | - | - | - | - | - |
| Total CECONY | \$10,573 | \$ - | \$787 | \$1,922 | \$549 | \$491 | \$32,605 | \$1,866 |
| O&R | | | | | | | | |
| Electric | \$ 692 | \$ - | \$ 32 | \$ 74 | \$ 22 | \$ 18 | \$ 1,630 | \$ 99 |
| Gas | 218 | - | 12 | 34 | 12 | 8 | 686 | 36 |
| Other* | - | - | - | - | 1 | - | 32 | - |
| Total O&R | \$ 910 | \$ - | \$ 44 | \$ 108 | \$ 35 | \$ 26 | \$ 2,348 | \$ 135 |
| Competitive energy businesses | \$ 1,883 | \$ 9 | \$ 9 | \$ 97 | \$ (3) | \$ 37 | \$ 828 | \$ 28 |
| Other** | (41) | (9) | - | (7) | 28 | - | 567 | - |
| Total Con Edison | \$13,325 | \$ - | \$840 | \$2,120 | \$609 | \$554 | \$36,348 | \$2,029 |
| As of and for the Year Ended December 31, 2009 (Millions of Dollars) | Operating revenues | Inter-segment revenues | Depreciation and amortization | Operating income | Interest charges | Income tax expense | Total assets* | Construction expenditures |
| CECONY | | | | | | | | |
| Electric | \$ 7,674 | \$ 12 | \$587 | \$1,368 | \$425 | \$300 | \$23,309 | \$1,596 |
| Gas | 1,701 | 5 | 98 | 309 | 82 | 90 | 4,796 | 339 |
| Steam | 661 | 73 | 59 | 39 | 46 | 12 | 2,356 | 122 |
| Consolidation adjustments | - | (90) | - | - | - | - | - | - |
| Total CECONY | \$10,036 | \$ - | \$744 | \$1,716 | \$553 | \$402 | \$30,461 | \$2,057 |
| O&R | | | | | | | | |
| Electric | \$ 648 | \$ - | \$ 30 | \$ 64 | \$ 18 | \$ 15 | \$ 1,525 | \$ 85 |
| Gas | 242 | - | 12 | 28 | 9 | 7 | 627 | 42 |
| Other* | - | - | - | - | 2 | - | 35 | - |
| Total O&R | \$ 890 | \$ - | \$ 42 | \$ 92 | \$ 29 | \$ 22 | \$ 2,187 | \$ 127 |
| Competitive energy businesses | \$ 2,147 | \$ - | \$ 5 | \$ 93 | \$ - | \$ 31 | \$ 751 | \$ 10 |
| Other** | (41) | - | - | (3) | 29 | - | 445 | - |
| Total Con Edison | \$13,032 | \$ - | \$791 | \$1,899 | \$611 | \$455 | \$33,844 | \$2,194 |

* Includes amounts related to the RECO securitization.

** Parent company expenses, primarily interest, and consolidation adjustments. Other does not represent a business segment.

Notes to the Financial Statements – Continued

Note O – Derivative Instruments and Hedging Activities

Under the accounting rules for derivatives and hedging, derivatives are recognized on the balance sheet at fair value, unless an exception is available under the accounting rules. Certain qualifying derivative contracts have been designated as normal purchases or normal sales contracts. These contracts are not reported at fair value under the accounting rules.

Energy Price Hedging

Con Edison's subsidiaries hedge market price fluctuations associated with physical purchases and sales of electricity, natural gas, and steam by using derivative instruments including futures, forwards, basis swaps, options, transmission congestion contracts and financial transmission rights contracts. The fair values of these hedges at December 31, 2011 and 2010 were as follows:

| (Millions of Dollars) | Con Edison | | CECONY | |
|---|------------|---------|---------|---------|
| | 2011 | 2010 | 2011 | 2010 |
| Fair value of net derivative assets/(liabilities) – gross | \$(249) | \$(261) | \$(144) | \$(156) |
| Impact of netting of cash collateral | 110 | 176 | 46 | 104 |
| Fair value of net derivative assets/(liabilities) – net | \$(139) | \$(85) | \$(98) | \$(52) |

Credit Exposure

The Companies are exposed to credit risk related to transactions entered into primarily for the various energy supply and hedging activities by the Utilities and the competitive energy businesses. The Companies use credit policies to manage this risk, including an established credit approval process, monitoring of counterparty limits, netting provisions within agreements, collateral or prepayment arrangements, credit insurance and credit default swaps.

At December 31, 2011, Con Edison and CECONY had \$119 million and \$12 million of credit exposure in connection with energy supply and hedging activities, net of collateral, respectively. Con Edison's net credit exposure consisted of \$45 million with investment-grade counterparties, \$38 million with commodity exchange brokers, \$33 million with independent system operators and \$3 million with non-rated counterparties. CECONY's net credit exposure was with commodity exchange brokers.

Economic Hedges

The Companies enter into certain derivative instruments that do not qualify or are not designated as hedges under the accounting rules for derivatives and hedging. However, management believes these instruments represent economic hedges that mitigate exposure to fluctuations in commodity prices.

Notes to the Financial Statements – Continued

The fair values of the Companies' commodity derivatives at December 31, 2011 were:

| (Millions of Dollars) | Fair Value of Commodity Derivatives(a) | | Con Edison | CECONY |
|------------------------------|---|--|------------|--------|
| | Balance Sheet Location | | | |
| Derivatives Asset | | | | |
| Current | Other current assets | | \$ 139 | \$ 16 |
| Long-term | Other deferred charges and non-current assets | | 26 | 14 |
| Total derivatives asset | | | \$ 165 | \$ 30 |
| Impact of netting | | | (95) | (6) |
| Net derivatives asset | | | \$ 70 | \$ 24 |
| Derivatives Liability | | | | |
| Current | Fair value of derivative liabilities | | \$ 331 | \$127 |
| Long-term | Fair value of derivative liabilities | | 83 | 48 |
| Total derivatives liability | | | \$ 414 | \$175 |
| Impact of netting | | | (205) | (53) |
| Net derivatives liability | | | \$ 209 | \$122 |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

The fair values of the Companies' commodity derivatives at December 31, 2010 were:

| (Millions of Dollars) | Fair Value of Commodity Derivatives(a) | | Con Edison | CECONY |
|------------------------------|---|--|------------|--------|
| | Balance Sheet Location | | | |
| Derivatives Asset | | | | |
| Current | Other current assets | | \$ 184 | \$ 29 |
| Long-term | Other deferred charges and non-current assets | | 51 | 19 |
| Total derivatives asset | | | \$ 235 | \$ 48 |
| Impact of netting | | | (129) | - |
| Net derivatives asset | | | \$ 106 | \$ 48 |
| Derivatives Liability | | | | |
| Current | Fair value of derivative liabilities | | \$ 385 | \$ 148 |
| Long-term | Fair value of derivative liabilities | | 111 | 56 |
| Total derivatives liability | | | \$ 496 | \$ 204 |
| Impact of netting | | | (305) | (104) |
| Net derivatives liability | | | \$ 191 | \$ 100 |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

The Utilities generally recover all of their prudently incurred fuel, purchased power and gas cost, including hedging gains and losses, in accordance with rate provisions approved by the applicable state utility commissions. See "Recoverable Energy Costs" in Note A. In accordance with the accounting rules for regulated operations, the Utilities record a regulatory asset or liability to defer recognition of unrealized gains and losses on

their electric and gas derivatives. As gains and losses are realized in future periods, they will be recognized as purchased power, gas and fuel costs in the Companies' consolidated income statements. Con Edison's competitive energy businesses record realized and unrealized gains and losses on their derivative contracts in earnings in the reporting period in which they occur.

Notes to the Financial Statements — Continued

The following table presents the changes in the fair values of commodity derivatives that have been deferred or recognized in earnings for the year ended December 31, 2011:

| Realized and Unrealized Gains/(Losses) on Commodity Derivatives(a) Deferred or Recognized in Income for the Year Ended December 31, 2011 | | | |
|---|----------------------------|------------|---------|
| (Millions of Dollars) | Balance Sheet Location | Con Edison | CECONY |
| Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations: | | | |
| Current | Deferred derivative gains | \$ (3) | \$ (2) |
| Long-term | Regulatory liabilities | (1) | (1) |
| Total deferred gains | | \$ (4) | \$ (3) |
| Current | Deferred derivative losses | \$ 26 | \$ 11 |
| Current | Recoverable energy costs | (247) | (185) |
| Long-term | Regulatory assets | 11 | 4 |
| Total deferred losses | | \$(210) | \$(170) |
| Net deferred losses | | \$(214) | \$(173) |
| Income Statement Location | | | |
| Pre-tax gain/(loss) recognized in income | | | |
| | Purchased power expense | \$ (78)(b) | \$ - |
| | Gas purchased for resale | (18) | - |
| | Non-utility revenue | (30)(b) | - |
| Total pre-tax gain/(loss) recognized in income | | \$(126) | \$ - |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

(b) For the year ended December 31, 2011, Con Edison recorded in non-utility operating revenues and purchased power expense an unrealized pre-tax gain/(loss) of \$(34) million and \$11 million, respectively.

The following table presents the changes in the fair values of commodity derivatives that have been deferred or recognized in earnings for the year ended December 31, 2010:

| Realized and Unrealized Gains/(Losses) on Commodity Derivatives(a) Deferred or Recognized in Income for the Year Ended December 31, 2010 | | | |
|---|----------------------------|------------|---------|
| (Millions of Dollars) | Balance Sheet Location | Con Edison | CECONY |
| Pre-tax gains/(losses) deferred in accordance with accounting rules for regulated operations: | | | |
| Current | Deferred derivative gains | \$ (5) | \$ (5) |
| Long-term | Regulatory liabilities | 1 | 1 |
| Total deferred gains | | \$ (4) | \$ (4) |
| Current | Deferred derivative losses | \$ (49) | \$ (47) |
| Current | Recoverable energy costs | (285) | (240) |
| Long-term | Regulatory assets | 32 | 27 |
| Total deferred losses | | \$(302) | \$(260) |
| Net deferred losses | | \$(306) | \$(264) |
| Income Statement Location | | | |
| Pre-tax gain/(loss) recognized in income | | | |
| | Purchased power expense | \$ (91)(b) | \$ - |
| | Gas purchased for resale | (9) | - |
| | Non-utility revenue | (38)(b) | - |
| Total pre-tax gain/(loss) recognized in income | | \$(138) | \$ - |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

(b) For the year ended December 31, 2010, Con Edison recorded in non-utility operating revenues and purchased power expense an unrealized pre-tax gain/(loss) of \$(36) million and \$56 million, respectively.

Notes to the Financial Statements — Continued

As of December 31, 2011, Con Edison had 1,328 contracts, including 572 CECONY contracts, which were considered to be derivatives under the accounting rules for derivatives and hedging (excluding qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts). The following table presents the number of contracts by commodity type:

| | Electric Derivatives | | | | Gas Derivatives | | Total Number Of Contracts(a) |
|------------|-------------------------------|------------|---------------------------------|--------|------------------------|------------|------------------------------|
| | Number of Energy Contracts(a) | MWhs(b) | Number of Capacity Contracts(a) | MWs(b) | Number of Contracts(a) | Dths(b) | |
| Con Edison | 687 | 15,602,445 | 46 | 6,499 | 595 | 97,101,500 | 1,328 |
| CECONY | 141 | 3,822,500 | - | - | 431 | 89,524,000 | 572 |

(a) Qualifying derivative contracts, which have been designated as normal purchases or normal sales contracts, are not reported at fair value under the accounting rules for derivatives and hedging and, therefore, are excluded from the table.

(b) Volumes are reported net of long and short positions.

The Companies also enter into electric congestion and gas basis swap contracts to hedge the congestion and transportation charges which are associated with electric and gas contracts and hedged volumes.

The collateral requirements associated with, and settlement of, derivative transactions are included in net cash flows from operating activities in the Companies' consolidated statement of cash flows. Most derivative instrument contracts contain provisions that may require the Companies to provide collateral on derivative instruments in net liability positions. The amount of collateral to be provided will depend on the fair value of the derivative instruments and the Companies' credit ratings.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position and collateral posted at December 31, 2011, and the additional collateral that would have been required to be posted had the lowest applicable credit rating been reduced one level and to below investment grade were:

| (Millions of Dollars) | Con Edison(a) | CECONY(a) |
|--|---------------|-----------|
| Aggregate fair value – net liabilities | \$209 | \$122 |
| Collateral posted | \$ 60 | \$ 53(b) |
| Additional collateral(c) (downgrade one level from current ratings(d)) | \$ 20 | \$ 11 |
| Additional collateral(c) (downgrade to below investment grade from current ratings(d)) | \$195(e) | \$ 83(e) |

(a) Non-derivative transactions for the purchase and sale of electricity and gas and qualifying derivative instruments, which have been designated as normal purchases or normal sales, are excluded from the table. These transactions primarily include purchases of electricity from independent system operators. In the event the Utilities and Con Edison's competitive energy businesses were no longer extended unsecured credit for such purchases, the Companies would be required to post collateral, which at December 31, 2011, would have amounted to an estimated \$51 million for Con Edison, including \$11 million for CECONY. For certain other such non-derivative transactions, the Companies could be required to post collateral under certain circumstances, including in the event counterparties had reasonable grounds for insecurity.

(b) Across the Utilities' energy derivative positions, credit limits for the same counterparties are generally integrated. At December 31, 2011, the Utilities posted combined collateral of \$58 million, including an estimated \$5 million attributable to O&R.

(c) The Companies measure the collateral requirements by taking into consideration the fair value amounts of derivative instruments that contain credit-risk-related contingent features that are in a net liabilities position plus amounts owed to counterparties for settled transactions and amounts required by counterparties for minimum financial security. The fair value amounts represent unrealized losses, net of any unrealized gains where the Companies have a legally enforceable right of setoff.

(d) The current ratings are Moody's, S&P and Fitch long-term credit rating of, as applicable, Con Edison (Baa1/BBB+/BBB+), CECONY (A3/A-/A-) or O&R (Baa1/A-/A-). Credit ratings assigned by rating agencies are expressions of opinions that are subject to revision or withdrawal at any time by the assigning rating agency.

(e) Derivative instruments that are net assets have been excluded from the table. At December 31, 2011, if Con Edison had been downgraded to below investment grade, it would have been required to post additional collateral for such derivative instruments of not more than \$19 million.

Interest Rate Swaps

O&R has an interest rate swap pursuant to which it pays a fixed-rate of 6.09 percent and receives a LIBOR-based variable rate. The fair value of this interest rate swap at December 31, 2011 was an unrealized loss of \$8 million, which has been included in Con Edison's consolidated balance sheet as a noncurrent liability/fair value of derivative liabilities and a regulatory asset. The increase in the fair value of the swap for the year ended December 31, 2011 was \$2 million. In the event O&R's credit rating was downgraded to BBB- or lower by S&P or Baa3 or lower by Moody's, the swap counterparty could elect to terminate the agreement and, if it did so, the parties would then be required to settle the transaction.

Notes to the Financial Statements — Continued

Note P — Fair Value Measurements

The accounting rules for fair value measurements and disclosures define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in a principal or most advantageous market. Fair value is a market-based measurement that is determined based on inputs, which refer broadly to assumptions that market participants use in pricing assets or liabilities. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Companies often make certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk, and the risks inherent in the inputs to valuation techniques. The Companies use valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs.

The accounting rules for fair value measurements and disclosures established a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value in three broad levels. The rules require that assets and liabilities be classified in their entirety based on the level of input that is significant to the fair value measurement. Assessing the significance of a particular input may require judgment considering factors specific to the asset or liability, and may affect the valuation of the asset or liability and their placement within the fair value hierarchy. The Companies classify fair value balances based on the fair value hierarchy defined by the accounting rules for fair value measurements and disclosures as follows:

- Level 1 – Consists of assets or liabilities whose value is based on unadjusted quoted prices in active markets at the measurement date. An active market is one in which transactions for assets or liabilities occur with sufficient frequency and volume to provide pricing information on an ongoing basis. This category includes contracts traded on active exchange markets valued using unadjusted prices quoted directly from the exchange.
- Level 2 – Consists of assets or liabilities valued using industry standard models and based on prices, other than quoted prices within Level 1, that are either directly or indirectly observable as of the measurement date. The industry standard models consider observable assumptions including time value, volatility factors, and current market and contractual prices for the underlying commodities, in addition to other economic measures. This category includes contracts traded on active exchanges or in over-the-counter markets priced with industry standard models.
- Level 3 – Consists of assets or liabilities whose fair value is estimated based on internally developed models or methodologies using inputs that are generally less readily observable and supported by little, if any, market activity at the measurement date. Unobservable inputs are developed based on the best available information and subject to cost benefit constraints. This category includes contracts priced using models that are internally developed and contracts placed in illiquid markets. It also includes contracts that expire after the period of time for which quoted prices are available and internal models are used to determine a significant portion of the value.

The valuation technique used by the Companies with regard to commodity derivatives and other assets that fall into either Level 2 or Level 3 is the market approach, which uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The valuation technique used by the Companies with regard to the interest rate contract that falls into Level 3 is the income approach which uses valuation techniques to convert future income stream amounts to a single amount in present value terms.

Notes to the Financial Statements — Continued

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are summarized below.

| (Millions of Dollars) | Level 1 | | Level 2 | | Level 3 | | Netting Adjustments(4) | | Total | |
|---------------------------|------------|--------|------------|--------|------------|--------|------------------------|--------|------------|--------|
| | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY |
| Derivative assets: | | | | | | | | | | |
| Commodity(1) | \$ 3 | \$ - | \$ 64 | \$ 8 | \$ 87 | \$ 11 | \$ (84) | \$ 5 | \$ 70 | \$ 24 |
| Other assets(3) | 76 | 76 | - | - | 99 | 90 | - | - | 175 | 166 |
| Total | \$79 | \$76 | \$ 64 | \$ 8 | \$186 | \$101 | \$ (84) | \$ 5 | \$245 | \$190 |
| Derivative liabilities: | | | | | | | | | | |
| Commodity | \$12 | \$ 4 | \$222 | \$122 | \$169 | \$ 37 | \$(194) | \$(41) | \$209 | \$122 |
| Transfer in(5)(6)(7) | - | - | 26 | 25 | 6 | 6 | - | - | 32 | 31 |
| Transfer out(5)(6)(7) | - | - | (6) | (6) | (26) | (25) | - | - | (32) | (31) |
| Commodity(1) | \$12 | \$ 4 | \$242 | \$141 | \$149 | \$ 18 | \$(194) | \$(41) | \$209 | \$122 |
| Interest rate contract(2) | - | - | - | - | 8 | - | - | - | 8 | - |
| Total | \$12 | \$ 4 | \$242 | \$141 | \$157 | \$ 18 | \$(194) | \$(41) | \$217 | \$122 |

- (1) A significant portion of the commodity derivative contracts categorized in Level 3 is valued using either an industry acceptable model or an internally developed model with observable inputs. The models also include some less readily observable inputs resulting in the classification of the entire contract as Level 3. See Note O.
- (2) See Note O.
- (3) Other assets are comprised of assets such as life insurance contracts within the Deferred Income Plan and Supplemental Retirement Income Plans, held in rabbi trusts.
- (4) Amounts represent the impact of legally-enforceable master netting agreements that allow the Companies to net gain and loss positions and cash collateral held or placed with the same counterparties.
- (5) The Companies' policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.
- (6) Transferred from Level 2 to Level 3 because of reassessment of the levels in the fair value hierarchy within which certain inputs fall.
- (7) Transferred from Level 3 to Level 2 because of availability of observable market data due to decrease in the terms of certain contracts from beyond one year as of December 31, 2010 to less than one year as of December 31, 2011.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are summarized below.

| (Millions of Dollars) | Level 1 | | Level 2 | | Level 3 | | Netting Adjustments(4) | | Total | |
|---------------------------|------------|--------|------------|--------|------------|--------|------------------------|--------|------------|--------|
| | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY | Con Edison | CECONY |
| Derivative assets: | | | | | | | | | | |
| Commodity(1) | \$ 2 | \$ 1 | \$ 72 | \$ 21 | \$144 | \$ 13 | \$(112) | \$ 13 | \$106 | \$ 48 |
| Other assets(3) | 65 | 64 | - | - | 101 | 92 | - | - | 166 | 156 |
| Total | \$67 | \$65 | \$ 72 | \$ 21 | \$245 | \$105 | \$(112) | \$ 13 | \$272 | \$204 |
| Derivative liabilities: | | | | | | | | | | |
| Commodity | \$ 4 | \$ 2 | \$270 | \$177 | \$205 | \$ 12 | \$(288) | \$(91) | \$191 | \$100 |
| Transfer in(5)(6)(7) | - | - | (36) | (36) | (9) | (9) | - | - | (45) | (45) |
| Transfer out(5)(6)(7) | - | - | 9 | 9 | 36 | 36 | - | - | 45 | 45 |
| Commodity(1) | \$ 4 | \$ 2 | \$243 | \$150 | 232 | 39 | \$(288) | \$(91) | \$191 | \$100 |
| Interest rate contract(2) | - | - | - | - | 10 | - | - | - | 10 | - |
| Total | \$ 4 | \$ 2 | \$243 | \$150 | \$242 | \$ 39 | \$(288) | \$(91) | \$201 | \$100 |

- (1) A significant portion of the commodity derivative contracts categorized in Level 3 is valued using either an industry acceptable model or an internally developed model with observable inputs. The models also include some less readily observable inputs resulting in the classification of the entire contract as Level 3. See Note O.
- (2) See Note O.
- (3) Other assets are comprised of assets such as life insurance contracts within the Deferred Income Plan and Supplemental Retirement Income Plans, held in rabbi trusts.
- (4) Amounts represent the impact of legally-enforceable master netting agreements that allow the Companies to net gain and loss positions and cash collateral held or placed with the same counterparties.
- (5) The Companies' policy is to recognize transfers into and transfers out of the levels at the end of the reporting period.
- (6) Transferred from Level 2 to Level 3 because of reassessment of the levels in the fair value hierarchy within which certain inputs fall.
- (7) Transferred from Level 3 to Level 2 because of availability of observable market data due to decrease in the terms of certain contracts from beyond one year as of December 31, 2009 to less than one year as of December 31, 2010.

Notes to the Financial Statements — Continued

The table listed below provides a reconciliation of the beginning and ending net balances for assets and liabilities measured at fair value for the years ended December 31, 2011 and 2010 and classified as Level 3 in the fair value hierarchy:

| For the Year Ended December 31, 2011 | | | | | | | | | |
|--------------------------------------|---|---|--|-----------|-----------|-------|-------------|----------------------------------|--|
| (Millions of Dollars) | Beginning Balance as of January 1, 2011 | Total Gains/(Losses) – Realized and Unrealized | | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of December 31, 2011 |
| | | Included in Earnings | Included in Regulatory Assets and Liabilities | | | | | | |
| Con Edison | | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | \$ (88) | \$ (113) | \$20 | \$32 | \$- | \$- | \$67 | \$20 | \$(62) |
| Interest rate contract | (10) | (3) | 2 | - | - | - | 3 | - | (8) |
| Other assets(1) | 101 | - | (2) | - | - | - | - | - | 99 |
| Total | \$ 3 | \$(116) | \$20 | \$32 | \$- | \$- | \$70 | \$20 | \$ 29 |
| CECONY | | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | \$ (26) | \$ (21) | \$ - | \$19 | \$- | \$- | \$ 2 | \$19 | \$ (7) |
| Other assets(1) | 92 | - | (2) | - | - | - | - | - | 90 |
| Total | \$ 66 | \$ (21) | \$ (2) | \$19 | \$- | \$- | \$ 2 | \$19 | \$ 83 |

(1) Amounts included in earnings are reported in investment and other income on the consolidated income statement.

| For the Year Ended December 31, 2010 | | | | | | | | | |
|--------------------------------------|---|---|--|-----------|-----------|-------|-------------|----------------------------------|--|
| (Millions of Dollars) | Beginning Balance as of January 1, 2010 | Total Gains/(Losses) – Realized and Unrealized | | Purchases | Issuances | Sales | Settlements | Transfer In/Out of Level 3 | Ending Balance as of December 31, 2010 |
| | | Included in Earnings | Included in Regulatory Assets and Liabilities | | | | | | |
| Con Edison | | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | \$(59) | \$(131) | \$17 | \$5 | \$- | \$- | \$107 | \$(27) | \$ (88) |
| Interest rate contract | (11) | (3) | 1 | - | - | - | 3 | - | (10) |
| Other assets(1) | 92 | 3 | 6 | - | - | - | - | - | 101 |
| Total | \$ 22 | \$(131) | \$24 | \$5 | \$- | \$- | \$110 | \$(27) | \$ 3 |
| CECONY | | | | | | | | | |
| Derivatives: | | | | | | | | | |
| Commodity | \$ (5) | \$ (14) | \$10 | \$ - | \$- | \$- | \$ 10 | \$(27) | \$ (26) |
| Other assets(1) | 83 | 3 | 6 | - | - | - | - | - | 92 |
| Total | \$ 78 | \$ (11) | \$16 | \$ - | \$- | \$- | \$ 10 | \$(27) | \$ 66 |

(1) Amounts included in earnings are reported in investment and other income on the consolidated income statement.

For the Utilities, realized gains and losses on Level 3 commodity derivative assets and liabilities are reported as part of purchased power, gas and fuel costs. The Utilities generally recover these costs in accordance with rate provisions approved by the applicable state public utilities commissions. See Note A. Unrealized gains and losses for commodity derivatives are generally deferred on the consolidated balance sheet in accordance with the accounting rules for regulated operations.

For the competitive energy businesses, realized and unrealized gains and losses on Level 3 commodity derivative assets and

liabilities are reported in non-utility revenues (\$33 million loss and \$37 million loss) and purchased power costs (\$29 million loss and \$43 million loss) on the consolidated income statement for the years ended December 31, 2011 and 2010, respectively. The change in fair value relating to Level 3 commodity derivative assets held at December 31, 2011 and 2010 is included in non-utility revenues (\$33 million loss and \$37 million loss), and purchased power costs (\$15 million gain and \$24 million gain) on the consolidated income statement for the years ended December 31, 2011 and 2010, respectively.

Notes to the Financial Statements — Continued

The accounting rules for fair value measurements and disclosures require consideration of the impact of nonperformance risk (including credit risk) from a market participant perspective in the measurement of the fair value of assets and liabilities. At December 31, 2011, the Companies determined that nonperformance risk would have no material impact on their financial position or results of operations. To assess nonperformance risk, the Companies considered information such as collateral requirements, master netting arrangements, letters of credit and parent company guarantees, and applied a market-based method by using the counterparty (for an asset) or the Companies' (for a liability) credit default swaps rates.

Note Q – Variable Interest Entities

The Companies have not identified any interests they have in any variable interest entity (VIE) that would require the Companies to include the financial position and results of operations of the VIE in the Companies' consolidated financial statements.

The accounting rules for consolidation address the consolidation of a VIE by a business enterprise that is the primary beneficiary. A VIE is an entity that does not have a sufficient equity investment at risk to permit it to finance its activities without additional subordinated financial support, or whose equity investors lack the characteristics of a controlling financial interest. The primary beneficiary is the business enterprise that has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and either absorbs a significant amount of the VIE's losses or has the right to receive benefits that could be significant to the VIE.

Con Edison enters into arrangements including leases, partnerships and electricity purchase agreements, with various entities. As a result of these arrangements, Con Edison retains or may retain a variable interest in these entities.

CECONY has a variable interest in a non-consolidated VIE, Astoria Energy, LLC (Astoria Energy), with which CECONY has entered into a long-term electricity purchase agreement. CECONY is not the primary beneficiary of this VIE since CECONY does not have the power to direct the activities that CECONY believes most significantly impact the economic performance of Astoria Energy. In particular, CECONY has not invested in, or guaranteed the indebtedness of, Astoria Energy and CECONY does not operate or maintain Astoria Energy's generating facilities. CECONY also has long-term electricity purchase agreements with the following five potential VIEs: Sithe/Independence Power Partners, LP, Cogen Technologies Linden Venture, LP, Selkirk Cogen Partners, LP, Brooklyn Navy Yard Cogeneration Partners, LP, and Indeck Energy Services of Corinth, Inc. In 2011, requests were made of these five

counterparties for information necessary to determine whether the entity was a VIE and whether CECONY is the primary beneficiary; however, the information was not made available. See Note I for information on these electricity purchase agreements, the payments pursuant to which constitute CECONY's maximum exposure to loss with respect to Astoria Energy and the five potential VIEs.

Con Edison has a variable interest in a non-consolidated VIE, Pilesgrove Solar, LLC (Pilesgrove), in which Con Edison Development, starting in 2010, participated with a third party to develop, construct, and operate a photovoltaic solar energy generation project. The project was constructed for approximately \$90 million and commenced commercial operation in August 2011. Con Edison is not the primary beneficiary of this VIE since the power to direct the activities that most significantly impact the economics of Pilesgrove is shared equally between Con Edison Development and the third party. Included in the Con Edison's consolidated balance sheet at December 31, 2011 is \$43 million in assets related to Pilesgrove which represents the investment of Con Edison Development. The current maximum exposure to loss in Pilesgrove is \$29 million.

Note R – Asset Retirement Obligations

Con Edison and CECONY account for retirement obligations on their assets in accordance with the accounting rules for asset retirement obligations. This accounting standard requires recognition of a liability for legal obligations associated with the retirement of long-lived assets. When the liability is initially recorded, asset retirement costs are capitalized by increasing the carrying amount of the related asset. The liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset.

The Utilities include in depreciation the estimated removal costs, less salvage, for utility plant assets. In accordance with the accounting rules for asset retirement obligations, future removal costs that do not represent legal asset retirement obligations are recorded as regulatory liabilities pursuant to the accounting rules for regulated operations. The related regulatory liabilities recorded for Con Edison and CECONY were \$448 million and \$372 million at December 31, 2011 and \$421 million and \$349 million at December 31, 2010, respectively.

The Companies identified future asset retirement obligations associated with the removal of asbestos and asbestos-containing material in their buildings and equipment within the generating stations and substations, and within the steam and gas distribution systems. The Companies also identified asset retirement obligations relating to gas pipelines abandoned in place. The estimates of future liabilities were developed using

Notes to the Financial Statements — Continued

historical information, and where available, quoted prices from outside contractors. The obligation for the cost of asbestos removal from the Companies' generating stations and substation structures was not accrued since the retirement dates cannot be reasonably estimated.

At December 31, 2011, the liabilities of Con Edison and CECONY for the fair value of their legal asset retirement obligations were \$145 million, as compared with \$109 million at December 31, 2010. In addition, Con Edison and CECONY increased utility plant, net of accumulated depreciation, for asset retirement costs at December 31, 2011 by \$38 million, as compared with \$18 million at December 31, 2010. Pursuant to the accounting rules for regulated operations, CECONY also recorded a reduction of \$107 million and \$91 million at December 31, 2011 and 2010, respectively, to the regulatory liability associated with cost of removal to reflect accumulated depreciation and interest accretion costs.

Note S – Related Party Transactions

The Utilities and Con Edison's competitive businesses provide administrative and other services to each other pursuant to cost allocation procedures approved by the NYSPSC. The costs of administrative and other services provided by CECONY to, and received by it from, Con Edison and its other subsidiaries for the years ended December 31, 2011, 2010, and 2009 were as follows:

| (Millions of Dollars) | CECONY | | |
|---------------------------|--------|------|------|
| | 2011 | 2010 | 2009 |
| Cost of services provided | \$79 | \$74 | \$75 |
| Cost of services received | \$48 | \$45 | \$45 |

In addition, CECONY and O&R have joint gas supply arrangements, in connection with which CECONY sold to O&R \$81 million, \$99 million and \$124 million of natural gas for the years ended December 31, 2011, 2010, and 2009, respectively. These amounts are net of the effect of related hedging transactions.

FERC has authorized CECONY through 2013 to lend funds to O&R from time to time, for periods of not more than 12 months, in amounts not to exceed \$250 million outstanding at any time, at prevailing market rates. There were no outstanding loans to O&R at December 31, 2011 and 2010.

Note T – New Financial Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued amendments to the guidance for fair value measurement through Accounting Standards Update (ASU) No. 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." The amendments expand Accounting Standards Codification 820's existing disclosure requirements for fair value measurements and makes other amendments. Many of these amendments were made to eliminate unnecessary wording differences between U.S. generally accepted accounting principles and International Financial Reporting Standards. For public entities, the amendments are effective prospectively during interim and annual periods beginning after December 15, 2011. The application of this guidance is not expected to have a material impact on the Companies' financial position, results of operations and liquidity.

In June 2011, the FASB issued new guidance for presentation of comprehensive income through ASU No. 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." The amendments require that the comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in this update are applicable retrospectively for public entities effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The application of this guidance does not have a material impact on the Companies' financial position, results of operations and liquidity.

In September 2011, the FASB issued amendments to the guidance for goodwill impairment testing through ASU No. 2011-08, "Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment." The amendments provide guidance that exempts an entity from calculating the fair value of a reporting unit, if on an initial assessment of qualitative factors it is more likely than not that the fair value of a reporting unit is greater than its carrying amount. For public entities, the amendments are effective for interim and annual goodwill tests performed for years beginning after December 15, 2011. The application of this guidance is not expected to have a material impact on the Companies' financial position, results of operations or liquidity.

Notes to the Financial Statements — Continued

In September 2011, the FASB issued amendments to guidance for disclosures related to retirement benefits through ASU No. 2011-09, "Compensation – Retirement Benefits – Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer's Participation in a Multiemployer Plan." The amendment provides guidance that requires employers to provide additional separate disclosures for multiemployer pension plans and multiemployer other postretirement benefit plans about the commitments an employer has made to a multiemployer plan and the potential future cash flow implication of participation in such a plan. For public entities, the amendments are effective for interim and annual periods ending after December 15, 2011. The application of this guidance is not expected to have a material impact on the Companies' financial position, results of operations or liquidity.

In December 2011, the FASB issued amendments to guidance for disclosures related to balance sheet off-setting through ASU No. 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities." The amendments provide guidance that requires a reporting entity to disclose certain quantitative information concerning financial and derivative instruments that are offset in the balance sheet and a description of the rights of setoff, including the nature of such rights, associated with recognized assets and liabilities that are subject to an enforceable master netting arrangement or similar agreement. For public companies, the amendments are effective

for annual periods beginning on or after January 1, 2013 and retrospectively for all comparative periods presented. The application of this guidance is not expected to have a material impact on the Companies' financial position, results of operations or liquidity.

In December 2011, the FASB issued amendments to guidance for disclosures related to reclassification adjustments through ASU No. 2011-12, "Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." The amendments defer the effective date for the requirements per ASU 2011-05 for the presentation of reclassification adjustments and the effect of such reclassification adjustments as a component of net income and a component of other comprehensive income. The guidance requires reporting entities to continue reporting reclassifications out of accumulated other comprehensive income on the face of, or the notes to the financial statements consistent with the presentation requirements in effect before update ASU 2011-05. The amendments in this update are applicable retrospectively for public entities effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The application of this guidance does not have a material impact on the Companies' financial position, results of operations and liquidity.

"Joel is a fantastic speaker & brings a lot of knowledge to the table. Found he often answered all my questions without asking." Richard Wathy, Team Lead Financial Reporting, Union Gas.

"Joel Berk is a known and valued commodity at our company." One of the seminar's strong points is "the big picture context which gives the mechanics and definitions meaning. I thought all the info was great." Stephen D. Nigloschy, Vice President Finance, National Grid.

"This is an excellent seminar that provides a solid foundation of knowledge for those unfamiliar with utility accounting and buttresses existing knowledge for those who work in utility ratemaking and accounting on a daily basis." Wes Owens, Manager Regulatory Affairs, San Jose Water.

"Excellent communications and teaching skills. Working for a utility almost 20 years, I wish I had this class at the start of my career." Roberta Cleveland, Financial Analyst, Idaho Power.

"One of the strong points of the seminar was "discussion on the current issues on troublesome account situations...bringing other company situations or financial statements into case studies, involving group discussions and covering the appropriate topics. The bond/credit ratings discussion was extremely beneficial." Kevin Christ, Manager Accounting & Reporting, Northern Natural Gas.

"Great presentation. Very helpful in decision making by financial analysis via financial statements & analysis. Simple, clear, sophisticated. I learned in two days the materials which took me two years in school to learn (Basic & Intermediate Accounting)." Tina Tran, Business Analyst, SCE.

"One of the best & most engaging seminars I have attended in 10+ years; reminds me of my Master's Degree seminars." Robert Lukosh, Telecom Engineer, NW Natural Gas.

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UTILITY FINANCE & ACCOUNTING SEMINARS

LAS VEGAS & BOSTON

"Joel provides in-depth training on fundamental issues in utility finance and accounting with a unique focus on timely subjects and does so in an enjoyable and engaging manner." John Caldwell, Director of Economics, Edison Electric.

"Easy to follow, straightforward teaching on the unique and complex arena of rate-based accounting and the principles behind regulatory rate making." Tony Mitchell, Project Management Office, Spectra Energy.

"Excellent. Met my needs for my job-I work with capital decisions, ratemaking, PPAs for an IOU." Kevin M. Pera, Transmission Analyst, Xcel Energy.

"I came away feeling confident that I really understood the material & can apply it in my day to day work." Linda Thompson, Director Ethics, Compliance & Federal Regulatory, APS.

"The most worthwhile & beneficial course I have taken while on the job." Casey A. Tomasiak, Property Valuation Specialist, FPL Group.

"Excellent resource for any employee. Should be mandatory for any new employees or those who manage Projects and Budgets." William Rochford, Section Manager IT Tech Operations, National Grid.

"Educational as well as entertaining. A great way to train new employees on basic utility accounting & finance. Instructor had an incredible amount of industry knowledge." David Thomason, Analysis & Reporting Manager, Pacific Gas & Electric.

"Joel Berk is the only accounting instructor I know who can make accounting interesting and fun for an engineer like me. Enjoyed the course immensely." James J. Bonner, Jr., Manager, National Grid.

UTILITY FINANCE & ACCOUNTING SEMINARS

FOR NON-FINANCIAL PROFESSIONALS

Course prerequisites: none. Advanced preparation: none.

UTILITY FINANCE & ACCOUNTING FOR NONFINANCIAL PROFESSIONALS

A comprehensive, 3 day, group-live seminar for nonfinancial individuals working with the utility industry or financial individuals who are new to the utility industry and who need to understand a) how the utility runs as a business b) the unique language of utility ratemaking, finance & accounting, c) the key aspects of the utility's four sets of books d) how to understand & "read" a utility's financial statements e) learn where the numbers come from on the balance sheet & income statement and f) how the regulators set rates & identify various features of ratemaking.

This seminar will enable you to understand: 1) accrual accounting 2) tax book temporary differences 3) present value analysis 4) basic financial statement analysis 5) basic rate of return regulation 6) incremental analysis for making capital budgeting decision. Program level: Basic. Recommended CPE Credits: 22.

DAY ONE: 8:00-4:00

Introduction

Basic Accounting Concepts

Balance Sheet

Income Statement

Learning Objective: Understanding of where the numbers come from that we use at the utility to run the company (managerial accounting), prepare the financial statements, set rates and prepare the company's tax return. This leads to gaining the insight needed to use accounting information to create shareholder value.

We use a spreadsheet approach in making accounting entries for a simple utility company which avoids the use of debits and credits. This is not a simplified version of accounting but a conceptual version perfectly suited to users of accounting information as contrasted with the debit and credit approach needed for preparers of accounting information (i.e., accountants). We develop the Income Statement and Balance Sheet and discuss the significance of these. We compare our simple example with the real financial statements of the company. While doing our transactions analysis (i.e., preparing the spreadsheet) we discuss general accounting concepts like the cost basis of accounting, accrual accounting, accounting methods and accounting estimates. Material which may be covered in more depth later such as the Statement of Cash Flows and Tax Book Temporary Differences is introduced.

Financial Statement Analysis

Return on Equity

Total Shareholder Return

Learning Objective: Mechanics of the calculations, relation to the accounting numbers used and the relation to the allowed ROE and Shareholder Value.

We calculate the ratios indicated above from the financials and market price data for the sample utility while discussing the significance of each measure.

The Utility's Four "Sets of Books"

Learning Objectives: Understanding of why we end up with different accounting methods and different accounting estimates for the four major uses of accounting.

GAAP, Tax, Rates, Managerial

Rate Case Concepts

Cost of Service Regulation

Rate Base, Operating Expenses, Allowed Return

Above-the-line versus Below-the-line Expenses

We discuss the conflicting goals of the groups who make accounting rules for the four major places where we use accounting data. This leads to a discussion of tax-book temporary differences as well as regulatory assets and liabilities. Most of the time in this session is spent on how ratemaking uses the accounting methods and estimates. We will look at the details of a rate case revenue requirement development.

Role Playing Exercise -- Rate Case

Learning Objective: See how different parties to the rate case are able to effectively argue their positions such that the utility can never be sure their position will prevail.

Interveners -- Consumer Group, Industrial Ratepayers

Rate Case Steps

Above-the-Line and Below-the-Line Issues

This is a role playing exercise. Groups of 4-6 people play the roles of Consumer Advocate, CEO of the Utility, Commission Staff Advisor, Large Industrial Ratepayer, CFO the Utility and the Commissioners. Each group presents arguments on why certain costs should or should not be included in rates.

Ethics Considerations

Learning Objective: Get insight through discussion of unethical behavior at some utility companies.

HOMEWORK PROBLEM: FINANCIAL STATEMENT ANALYSIS

Calculation of the ratios discussed today from the financials and market price data for a real utility company.

COCKTAILS 4:30 - 5:30

DAY TWO: 8:00-4:00

LEARNING OBJECTIVES:

To provide a working understanding of finance & accounting as applied to the regulated utility companies. Upon completion of the seminar (group-live) participants will be able to:

- Understand accrual accounting
- "Read" an annual report of the company
- Calculate key financial ratios
- See the link between finance & accounting & the strategic plans of the company

Review of Homework

Modifications to Rate of Return Regulation

Learning Objective: To see the many different regulatory mechanisms which are possible and the implications of alternative regulatory frameworks.

Adjustment Clauses and Cost Recovery Rates

Decoupling

Formula Ratemaking

Rate Freezes

Pre-approvals

We discuss the many different ways of modifying the traditional rate of return regulatory framework along with a discussion of what each accomplishes for the utility.

Present Value Analysis and Exercise

Learning Objective: Be able to calculate the present value of a series of cash flows.

We begin with compound interest and risk and return. Then we turn around the compound interest solution to see how it becomes present value analysis. A present value problem follows.

Shareholder Value Maximization

Learning Objective: Learn how to make decisions in order to increase the stock price.

Theory

Measurement Techniques

Risk Measurement

Relationship to Accounting Performance Measures

Financing Decisions, Operating Decisions & Investing Decisions

We develop the concept of shareholder value maximization as the present value of the future free cash flows. All decisions at the firm should be made by incremental analysis of the future free cash flows as impacted by the four sets of books. Illustrations of common financing, investing and operating decisions are used.

Accounting for Utility Plant

Learning Objective: Appreciation of the fact that there is ambiguity in whether costs should be capitalized or expensed and the implications of the choice.

Capitalization Versus Expense

Methods of Capitalizing More or Less

Which is Better for the Utility

Retirement Units of Property

Straight Line Depreciation

Accelerated Depreciation

We look at straight line and accelerated depreciation for the four sets of books. We discuss the issue of when to capitalize costs in terms of units of property. Some conclusions are drawn as to what would be a better method for the company--to capitalize costs or expense them.

DAY THREE: 8:00-3:00

Accounting for Income Taxes

Learning Objective: Understanding the accounting for tax-book differences and normalization versus flow through for ratemaking.

Temporary Differences

We discuss the use of normalization or flow through for ratemaking. We look at the utility's deferred tax balances, where they came from and the ratemaking implications. An illustration of the flow through regulatory asset is included.

Cost of Capital

Learning Objective: To be able to calculate the two different weighted average cost of capital figures for the company, one which is used for ratemaking and the other for capital budgeting.

Cost of Debt and Preferred

Cost of Equity

Comparable Companies

Weighted Average Cost of Capital

After introductory material we will determine the cost of debt, preferred and equity for a utility. Two methods of determining the cost of equity will be used -- the DCF method and the risk premium approach. Testimony from rate cases will be reviewed.

Capital Project Analysis Review Case

Learning Objective: Learn to do a present value analysis using incremental cash flows as impacted by the four sets of books.

Identify Incremental Cash Flows as Opposed to Accrual Figures

Measuring Impact on Shareholder Value

Selecting the Appropriate Discount Rate

Use a Spread Sheet Approach

Incorporate Into the Analysis Tax and Ratemaking Impacts on Cash Flows

Shareholder Value Measurement

As a group project we will prepare a spreadsheet to see whether a capital project should be done. The groups will present answers to questions which come up in the analysis. The project and the presentations of answers is a comprehensive hands-on review of much of the material in the seminar.

Conclusions

UTILITY FINANCE & ACCOUNTING SEMINARS

FOR FINANCIAL PROFESSIONALS

Course prerequisites: Completion of FAI's Seminar for Non-Financial Professionals or a position in the finance, accounting or the rates area or an educational background including at least three classes in accounting. Advanced Preparation: None except preceding.

UTILITY FINANCE & ACCOUNTING FOR FINANCIAL PROFESSIONALS

An in-depth three day group-live seminar for financial professionals who already work in the area of utility finance & accounting who need to enhance their understanding of critical finance & accounting skills including GAAP for utilities, capitalization versus expense, bond ratings, IFRS & accounting for taxes.

Program level: Intermediate. Recommended CPE Credits: 22

DAY ONE: 8:00-4:00

Calculation of ROE for the Utility

Learning Objective: Mechanics of the calculation and relation to the allowed ROE.

We begin before 8 am (for those who arrive early) with an individual assignment using the financial statements of a real utility company.

Rate of Return Regulation

Learning Objectives: Understanding of why ratemaking drives the GAAP accounting and how different accounting methods and different accounting estimates are used for four major uses of accounting.

GAAP Rates

Tax Managerial

We discuss the conflicting goals of the groups who make accounting rules for the four major places where we use accounting data. This leads to a preliminary discussion of tax-book temporary and permanent differences as well as ASC 980 regulatory assets and liabilities. Most of the time in this session is spent on how ratemaking uses the accounting methods and estimates. We will look at the details of the rate case revenue requirement development.

Modifications to Rate of Return Regulation

Learning Objective: To see the many different regulatory mechanisms which are possible and the implications of alternative regulatory frameworks.

Adjustment Clauses and Cost Recovery Rates

Rate Freezes

Decoupling

Pre-approvals

Formula Ratemaking

We discuss the many different ways of modifying the traditional rate of return regulatory framework along with a discussion of what each accomplishes for the utility.

Energy Adjustment Clauses

Learning Objective: To see how adjustment mechanisms work and reduce risk at the utility.

Theory of these Ratemaking Adjustments

Examples of Fuel, Gas and Weatherization Normalization Clauses

Implications for Making Management Decisions

After an introduction to this topic and a discussion of the many different types of clauses and the different ways that they work, we work on a group project to see the implications for decision making when the utility has an adjustment mechanism in place. We look at rate review proceedings concerning the adjustment clause.

GAAP For Utilities

Learning Objective: Understanding the applicability of ASC 980 and why its provisions make sense.

Why and How GAAP Differs from non-regulated operations

Regulatory Assets and When to Remove Them

Plant Write-Offs Under GAAP

We discuss specific pieces of GAAP with examples from the financials. We review the utility's note on Significant Accounting Policies to see in which area the utility violates normal GAAP. We look at each of the regulatory assets and liabilities of a utility as shown on the financials and answer the question--why is this a regulatory asset or regulatory liability and not a normal asset or liability.

COCKTAILS 4:30 - 5:30

DAY TWO: 8:00-4:00

Capitalization Versus Expense

Learning Objective: Mastering the theory of capitalization versus expense and the motivations of managers and top management with respect to the issue.

Influences and Motivations

Financial Reporting, Tax Accounting, Ratemaking, Managerial Accounting

Problems in Recovery of Plant Costs

Retirement Units of Property

We discuss the impact on the numbers in the four sets of books when costs are capitalized rather than expensed and vice versa. Using an example of plant overhaul costs we analyze the impact on rates.

Plant Issues

Learning Objective: Appreciation of the significance of the ratemaking estimates of the life and removal costs and how under normal conditions errors in the estimates are corrected through accumulated depreciation.

Accounting for Plant Retirement

Risks of a Reserve Deficiency

Asset Retirement Obligations

Mass Property Accounting

We go through the accounting for retirement of plant. This accounting differs from most

nonregulated companies. The large regulatory liability which shows up is discussed. Also discussed is the concept of reserve deficiency.

Accounting for Income Taxes

Learning Objective: Understanding the accounting for tax-book differences and normalization versus flow through for ratemaking.

Permanent Differences

Temporary Differences

We will talk about two different income tax issues; most the time is spent on the use of normalization or flow through for ratemaking. We look at the utility's deferred tax balances, where they came from and the ratemaking implications. An illustration of the regulatory tax asset is included.

A Problem of Definition

Learning Objective: To recognize the different terminology used by the utility industry and by Wall Street.

Statement of Cash Flows

Different Definitions for New Income, Op Inc and Cash Flow

We begin with the Statement of Cash Flow. We look at how and why the utility sometimes organizes its Balance Sheet and Income Statement differently than other companies. Then we investigate the many meanings of the terms Net Income, Operating Income and Cash Flow.

DAY THREE: 8:00-3:00

CWIP AND AFUDC

Learning Objective: Understanding how the utility recovers its construction financing costs from the ratepayers.

AFUDC versus Interest Capitalization

Analysis of the two methods of rate setting --CWIP in rate base and CWIP not in rate base. Comparison of interest capitalization under usual GAAP and the regulated company's method.

Accounting Methods and their Impact on Financial Metrics

Learning Objective: Gain an understanding that key financial measures and ratios can be significantly influenced by alternative accounting methods and estimates.

EBITDA

Cash Flow

EPS

Debt/Capitalization

Leasing Example

We will look at how key financial measures are impacted by the classification of transactions under GAAP and how the classification for ratemaking can impact rates. Examples of the difference between Operating or Capital Lease Accounting will be studied.

Credit Rating

Learning Objective: See how the bond raters rate the bonds of a company in order to see what we need to do as a company to improve or maintain our rating.

S&P Targets for Bond Rating

Capitalization Ratios

Funds Flow Ratios

Adjustments to Financial Statement Figures

This is a specific example using the financial statements in financial analysis. We focus on how S&P uses ratios to determine the bond rating for a company. We compare our answer to the actual rating.

LEARNING OBJECTIVES: Professional development to enhance the understanding of critical finance and accounting skills. Upon completion of the seminar (group-live) participants will be able to:

- Learn the mechanics of the calculation of ROE
- Understand why different accounting methods and estimates are used for setting rates; managerial accounting and GAAP
- Learn the applicability of ASC 980
- Understand the theory of capitalization versus expense and the motivations of managers with respect to the issue
- Understand the role of depreciation in ratemaking estimates
- Find out how the utility recovers its construction financing costs from ratepayers
- Learn the difference between normalization versus flow through for ratemaking

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INSTRUCTOR:

DR. JOEL BERK's stimulating and intensive "mini-MBA" course for the utility industry incorporates lecture, discussion, individual and group work and homework. Dr. Berk was a professor for thirteen years at the Graduate School of Business, Columbia University. He also has taught in the EEI Rate Fundamentals Course, AGA Gas Rate Fundamentals Program, Columbia University's Columbia Institute for Tele-Information Training Workshop, the University of Idaho's Public Utility Executive Course, Rutgers' Executive Management Program, and for the Southeast Electric Exchange and the US State Department.

A recipient of the William H. Newman Award for Teaching Excellence and Innovation, Dr. Berk's unique teaching style and abilities are endorsed by the thousands of industry professionals who have taken his courses as well as the over 200 utilities, investment banks, law firms, public utility commissions and other organizations for whom he has customized and taught on site programs.

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