Tennessee Valley Authority
Form 10-Q
February 03, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)
x QUARTERLY REPORT PURSUANT TO SECTION 13, 15(d), OR 37 OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2015
OR
o 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 000-52313

TENNESSEE VALLEY AUTHORITY
(Exact name of registrant as specified in its charter)

A corporate agency of the United States created by an act of Congress (State or other jurisdiction of incorporation or organization)	62-0474417 (IRS Employer Identification No.)
400 W. Summit Hill Drive Knoxville, Tennessee (Address of principal executive offices)	37902 (Zip Code)

(865) 632-2101
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13, 15(d), or 37 of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o
Non-accelerated filer x Smaller reporting company o
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

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GLOSSARY OF COMMON ACRONYMS

Following are definitions of terms or acronyms that may be used in this Quarterly Report on Form 10-Q for the quarter ended December 31, 2015 (the “Quarterly Report”):

Term or Acronym	Definition
AFUDC	Allowance for funds used during construction
AOCI	Accumulated other comprehensive income (loss)
ARO	Asset retirement obligation
ART	Asset Retirement Trust
ASLB	Atomic Safety and Licensing Board
BEST	Bellefonte Efficiency and Sustainability Team
BREDL	Blue Ridge Environmental Defense League
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
CCP	Coal combustion products
CCR	Coal combustion residual
CME	Chicago Mercantile Exchange
CO_2	Carbon dioxide
COL	Combined construction and operating license
COLA	Cost-of-living adjustment
CSAPR	Cross State Air Pollution Rule
CTs	Combustion turbine unit(s)
CVA	Credit valuation adjustment
CY	Calendar year
DCP	Deferred Compensation Plan
DOE	Department of Energy
EPA	Environmental Protection Agency
ESPA	Early Site Permit Application
FASB	Financial Accounting Standards Board
FCM	Futures Commission Merchant
FERC	Federal Energy Regulatory Commission
FTP	Financial Trading Program
GAAP	Accounting principles generally accepted in the United States of America
GAO	Government Accountability Office
GHG	Greenhouse gas
GWh	Gigawatt hour(s)
IRP	Integrated Resource Plan
JSCCG	John Sevier Combined Cycle Generation LLC
kWh	Kilowatt hour(s)
LIBOR	London Interbank Offered Rate
LPC	Local power company customer of TVA
LTDCP	Long-Term Deferred Compensation Plan
MATS	Mercury and Air Toxics Standards
MD&A	Management’s Discussion and Analysis of Financial Condition and Results of Operations
MISO	Midcontinent Independent System Operator, Inc.
mmBtu	Million British thermal unit(s)
MtM	Mark-to-market
MW	Megawatt

NAAQS	National Ambient Air Quality Standards
NAV	Net asset value

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NDT	Nuclear Decommissioning Trust
NEPA	National Environmental Policy Act
NERC	North American Electric Reliability Corporation
NO_x	Nitrogen oxide
NPDES	National Pollutant Discharge Elimination System
NRC	Nuclear Regulatory Commission
OCI	Other Comprehensive Income (Loss)
PM	Particulate matter
QER	Quadrennial Energy Review
QTE	Qualified technological equipment and software
REIT	Real Estate Investment Trust
SACE	Southern Alliance for Clean Energy
SCCG	Southaven Combined Cycle Generation LLC
SCRs	Selective catalytic reduction systems
SEC	Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
Seven States	Seven States Power Corporation
SHLLC	Southaven Holdco LLC
SMR	Small modular reactor(s)
SO_2	Sulfur dioxide
SSSL	Seven States Southaven, LLC
TCWN	Tennessee Clean Water Network
TDEC	Tennessee Department of Environment & Conservation
TOU	Time-of-use
TVARS	Tennessee Valley Authority Retirement System
TN Board	Tennessee Board of Water Quality, Oil and Gas
U.S. Treasury	United States Department of the Treasury
VIE	Variable interest entity
XBRL	eXtensible Business Reporting Language

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FORWARD-LOOKING INFORMATION

This Quarterly Report contains forward-looking statements relating to future events and future performance. All statements other than those that are purely historical may be forward-looking statements. In certain cases, forward-looking statements can be identified by the use of words such as “may,” “will,” “should,” “expect,” “anticipate,” “beli “intend,” “project,” “plan,” “predict,” “assume,” “forecast,” “estimate,” “objective,” “possible,” “probably,” “likely,” “potentia other similar expressions.

Although the Tennessee Valley Authority ("TVA") believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things:

- New, amended, or existing, laws, regulations, or administrative orders, including those related to environmental matters, and the costs of complying with these laws, regulations, and administrative orders;
- The cost of complying with known, anticipated, and new emissions reduction requirements, some of which could render continued operation of many of TVA's aging coal-fired generation units not cost-effective and result in their removal from service, perhaps permanently;
- Actions taken, or inaction, by the U.S. government relating to the national debt ceiling or automatic spending cuts in government programs;
- Costs and liabilities that are not anticipated in TVA’s financial statements for third-party claims, natural resource damages, or fines or penalties associated with unexpected events such as failures of a facility or infrastructure as well as for environmental clean-up activities;
- Addition or loss of customers by TVA or the local power company customers of TVA ("LPCs");
- Significant changes in demand for electricity which may result from, among other things, economic downturns, increased energy efficiency and conservation, and improvements in distributed generation or other alternative generation technologies;
- Significant delays, cost increases, or cost overruns associated with the construction of generation or transmission assets;
- Changes in the timing or amount of pension and health care costs and related funding;
- Increases in TVA's financial liabilities for decommissioning its nuclear facilities or retiring other assets;
- Physical or cyber attacks on TVA's assets;
- The outcome of legal or administrative proceedings;
- The failure of TVA's generation, transmission, flood control, and related assets, including coal combustion residual ("CCR") facilities, to operate as anticipated, resulting in lost revenues, damages, and other costs that are not reflected in TVA’s financial statements or projections;
- Differences between estimates of revenues and expenses and actual revenues earned and expenses incurred;
- Weather conditions;
- Catastrophic events such as fires, earthquakes, explosions, solar events, electromagnetic pulses, droughts, floods, hurricanes, tornadoes, pandemics, wars, national emergencies, terrorist activities, and other similar events, especially if these events occur in or near TVA's service area;
- Events at a TVA facility, which, among other things, could result in loss of life, damage to the environment, damage to or loss of the facility, and damage to the property of others;
- Events or changes involving transmission lines, dams, and other facilities not operated by TVA, including those that affect the reliability of the interstate transmission grid of which TVA's transmission system is a part and those that increase flows across TVA's transmission grid;
- Disruption of fuel supplies, which may result from, among other things, weather conditions, production or transportation difficulties, labor challenges, or environmental laws or regulations affecting TVA's fuel suppliers or

transporters;

- Purchased power price volatility and disruption of purchased power supplies;
- Events which affect the supply of water for TVA's generation facilities;
- Changes in TVA's determinations of the appropriate mix of generation assets;
- TVA's organizational transformation efforts or cost reduction efforts not being fully successful;
- Inability to obtain, or loss of, regulatory approval for the construction or operation of assets;
- The requirement or decision to make additional contributions to TVA's pension or other post-retirement benefit plans or to TVA's Nuclear Decommissioning Trust ("NDT") or Asset Retirement Trust ("ART");
- Limitations on TVA's ability to borrow money which may result from, among other things, TVA's approaching or substantially reaching the limit on bonds, notes, and other evidences of indebtedness specified in the Tennessee Valley Authority Act of 1933, as amended;
- An increase in TVA's cost of capital which may result from, among other things, changes in the market for TVA's debt securities, changes in the credit rating of TVA or the U.S. government, or, potentially, an increased reliance by TVA on alternative financing should TVA approach its debt limit;
- Changes in the economy and volatility in financial markets;
- Changes in technology;
- Reliability and creditworthiness of counterparties;
- Changes in the market price of commodities such as coal, uranium, natural gas, fuel oil, crude oil, construction materials, reagents, electricity, and emission allowances;

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- Changes in the market price of equity securities, debt securities, and other investments;
- Changes in interest rates, currency exchange rates, and inflation rates;
- Ineffectiveness of TVA's disclosure controls and procedures or its internal control over financial reporting;
- Inability to eliminate identified deficiencies in TVA's systems, standards, controls, or corporate culture;
- Inability to attract or retain a skilled workforce;
- Events at a nuclear facility, whether or not operated by or licensed to TVA, which, among other things, could lead to increased regulation or restriction on the construction, ownership, operation, and decommissioning of nuclear facilities or on the storage of spent fuel, obligate TVA to pay retrospective insurance premiums, reduce the availability and affordability of insurance, increase the costs of operating TVA's existing nuclear units, negatively affect the feasibility of preserving Bellefonte Nuclear Plant ("Bellefonte") Unit 1 for possible completion, and cause TVA to forego future construction at these or other facilities;
- Loss of quorum of the TVA Board of Directors; and
- Other unforeseeable events.

See also Item 1A, Risk Factors, and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in TVA's Annual Report on Form 10-K for the fiscal year ended September 30, 2015 (the "Annual Report"), and
Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report for a discussion of factors that could cause actual results to differ materially from those in a forward-looking statement. New factors emerge from time to time, and it is not possible for TVA to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ materially from those contained in any forward-looking statement. TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.

GENERAL INFORMATION

Fiscal Year

References to years (2016, 2015, etc.) in this Quarterly Report are to TVA's fiscal years ending September 30. Years that are preceded by "CY" are references to calendar years.

Notes

References to "Notes" are to the Notes to Consolidated Financial Statements contained in Part I, Item 1, Financial Statements in this Quarterly Report.

Available Information

TVA's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K for the preceding five years, as well as all amendments to those reports, are available on TVA's web site, free of charge, as soon as reasonably practicable after such reports are electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). TVA's web site is www.tva.gov. Information contained on TVA's web site shall not be deemed to be incorporated into, or to be a part of, this Quarterly Report. All TVA SEC reports are available to the public without charge from the web site maintained by the SEC at www.sec.gov.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
Three months ended December 31
(in millions)

	2015	2014
Operating revenues		
Revenue from sales of electricity	$2,246	$2,375
Other revenue	34	36
Total operating revenues	2,280	2,411
Operating expenses		
Fuel	480	550
Purchased power	247	233
Operating and maintenance	740	688
Depreciation and amortization	461	452
Tax equivalents	124	124
Total operating expenses	2,052	2,047
Operating income	228	364
Other income (expense), net	12	9
Interest expense		
Interest expense	335	342
Allowance for funds used during construction	(58)	(50)
Net interest expense	277	292
Net income (loss)	$(37)	$81

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

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)
Three months ended December 31
(in millions)

	2015	2014
Net income (loss)	$(37)	$81
Other comprehensive income (loss)		
Net unrealized gain (loss) on cash flow hedges	(27)	(15)
Reclassification to earnings from cash flow hedges	24	38
Total other comprehensive income (loss)	$(3)	$23
Total comprehensive income (loss)	$(40)	$104

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
ASSETS

	December 31, 2015	September 30, 2015
Current assets	(Unaudited)	
Cash and cash equivalents	$311	$300
Restricted cash and investments	20	15
Accounts receivable, net	1,239	1,600
Inventories, net	1,146	1,031
Regulatory assets	503	506
Other current assets	65	54
Total current assets	3,284	3,506
Property, plant, and equipment		
Completed plant	50,457	50,069
Less accumulated depreciation	(26,653)	(26,318)
Net completed plant	23,804	23,751
Construction in progress	7,413	7,147
Nuclear fuel	1,409	1,415
Capital leases	102	94
Total property, plant, and equipment, net	32,728	32,407
Investment funds	2,083	2,011
Regulatory and other long-term assets		
Regulatory assets	10,237	10,418
Other long-term assets	410	403
Total regulatory and other long-term assets	10,647	10,821
Total assets	$48,742	$48,745

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
LIABILITIES AND PROPRIETARY CAPITAL

	December 31, 2015	September 30, 2015
Current liabilities	(Unaudited)	
Accounts payable and accrued liabilities	$1,814	$2,127
Accrued interest	344	366
Current portion of leaseback obligations	79	79
Current portion of energy prepayment obligations	100	100
Regulatory liabilities	182	164
Short-term debt, net	1,504	1,034
Current maturities of power bonds	554	32
Current maturities of long-term debt of variable interest entities	33	33
Total current liabilities	4,610	3,935
Other liabilities		
Post-retirement and post-employment benefit obligations	7,124	7,107
Asset retirement obligations	3,668	3,682
Other long-term liabilities	2,149	2,219
Leaseback obligations	537	537
Energy prepayment obligations	185	210
Regulatory liabilities	4	2
Total other liabilities	13,667	13,757
Long-term debt, net		
Long-term power bonds, net	22,071	22,617
Long-term debt of variable interest entities, net	1,233	1,233
Total long-term debt, net	23,304	23,850
Total liabilities	41,581	41,542
Proprietary capital		
Power program appropriation investment	258	258
Power program retained earnings	6,321	6,357
Total power program proprietary capital	6,579	6,615
Nonpower programs appropriation investment, net	587	590
Accumulated other comprehensive income (loss)	(5)	(2)
Total proprietary capital	7,161	7,203
Total liabilities and proprietary capital	$48,742	$48,745

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For the three months ended December 31
(in millions)

	2015	2014
Cash flows from operating activities		
Net income (loss)	$(37)	$81
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization (including amortization of debt issuance costs and premiums/discounts)	472	463
Amortization of nuclear fuel cost	63	72
Non-cash retirement benefit expense	82	84
Prepayment credits applied to revenue	(25)	(25)
Fuel cost adjustment deferral	37	(6)
Fuel cost tax equivalents	(7)	(9)
Changes in current assets and liabilities		
Accounts receivable, net	375	311
Inventories and other, net	(104)	(120)
Accounts payable and accrued liabilities	(246)	(348)
Accrued interest	(22)	(42)
Regulatory assets costs	(11)	(12)
Insurance recoveries	7	50
Other, net	(68)	(26)
Net cash provided by operating activities	516	473
Cash flows from investing activities		
Construction expenditures	(866)	(751)
Nuclear fuel expenditures	(101)	(219)
Loans and other receivables		
Advances	(2)	(10)
Repayments	1	2
Other, net	—	(20)
Net cash used in investing activities	(968)	(998)
Cash flows from financing activities		
Long-term debt		
Redemptions and repurchases of power bonds	(4)	(4)
Short-term debt issues (redemptions), net	470	521
Payments on leases and leasebacks	(2)	(2)
Payments to U.S. Treasury	(2)	(1)
Other, net	1	10
Net cash provided by (used in) financing activities	463	524
Net change in cash and cash equivalents	11	(1)
Cash and cash equivalents at beginning of period	300	500
Cash and cash equivalents at end of period	$311	$499
Supplemental disclosures		
Significant non-cash transactions		
Accrued capital and nuclear fuel expenditures	$372	$237

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

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TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the three months ended December 31, 2015 and 2014
(in millions)

	Power Program Appropriation Investment	Power Program Retained Earnings	Nonpower Programs Appropriation Investment, Net	Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow Hedges	Total
Balance at September 30, 2014 (unaudited)	$258	$5,240	$601	$5	$6,104
Net income (loss)	—	84	(3)	—	81
Total other comprehensive income (loss)	—	—	—	23	23
Return on power program appropriation investment	—	(1)	—	—	(1)
Balance at December 31, 2014 (unaudited)	$258	$5,323	$598	$28	$6,207
Balance at September 30, 2015 (unaudited)	$258	$6,357	$590	$(2)	$7,203
Net income (loss)	—	(34)	(3)	—	(37)
Total other comprehensive income (loss)	—	—	—	(3)	(3)
Return on power program appropriation investment	—	(2)	—	—	(2)
Balance at December 31, 2015 (unaudited)	$258	$6,321	$587	$(5)	$7,161

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollars in millions except where noted)

1. Nature of Operations and Summary of Significant Accounting Policies

General

The Tennessee Valley Authority ("TVA") is a corporate agency and instrumentality of the United States that was created in 1933 by legislation enacted by the United States ("U.S.") Congress in response to a request by President Franklin D. Roosevelt. TVA was created to, among other things, improve navigation on the Tennessee River, reduce the damage from destructive flood waters within the Tennessee River system and downstream on the lower Ohio and Mississippi Rivers, further the economic development of TVA's service area in the southeastern United States, and sell the electricity generated at the facilities TVA operates.

Today, TVA operates the nation's largest public power system and supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky and in portions of northern Georgia, western North Carolina, and southwestern Virginia to a population of nine million people.

TVA also manages the Tennessee River, its tributaries, and certain shorelines to provide, among other things, year-round navigation, flood damage reduction, and affordable and reliable electricity. Consistent with these primary purposes, TVA also manages the river system to provide recreational opportunities, adequate water supply, improved water quality, natural resource protection, and economic development.

The power program has historically been separate and distinct from the stewardship programs. It is required to be self-supporting from power revenues and proceeds from power financings, such as proceeds from the issuance of bonds, notes, or other evidences of indebtedness ("Bonds"). Although TVA does not currently receive congressional appropriations, it is required to make annual payments to the United States Department of the Treasury ("U.S. Treasury") as a return on the government's appropriation investment in TVA's power facilities (the "Power Program Appropriation Investment"). In the 1998 Energy and Water Development Appropriations Act, Congress directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and nonpower or stewardship properties with power revenues in the event that there were insufficient appropriations or other available funds to pay for such activities in any fiscal year. Congress has not provided any appropriations to TVA to fund such activities since 1999. Consequently, during 2000, TVA began paying for essential stewardship activities primarily with power revenues, with the remainder funded with user fees and other forms of revenues derived in connection with those activities. The activities related to stewardship properties do not meet the criteria of an operating segment under accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, these assets and properties are included as part of the power program, TVA's only operating segment.

Power rates are established by the TVA Board of Directors (the "TVA Board") as authorized by the Tennessee Valley Authority Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (the “TVA Act”). The TVA Act requires TVA to charge rates for power that will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes ("tax equivalents"); debt service on outstanding indebtedness;

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payments to the U.S. Treasury in repayment of and as a return on the Power Program Appropriation Investment; and such additional margin as the TVA Board may consider desirable for investment in power system assets, retirement of outstanding Bonds in advance of maturity, additional reduction of the Power Program Appropriation Investment, and other purposes connected with TVA's power business. In setting TVA's rates, the TVA Board is charged by the TVA Act to have due regard for the primary objectives of the TVA Act, including the objective that power shall be sold at rates as low as are feasible. Rates set by the TVA Board are not subject to review or approval by any state or other federal regulatory body. TVA fulfilled its requirement to repay $1.0 billion of the Power Program Appropriation Investment in 2014.

Fiscal Year

TVA's fiscal year ends September 30. Years (2016, 2015, etc.) refer to TVA's fiscal years unless they are preceded by “CY,” in which case the references are to calendar years.

Cost-Based Regulation

Since the TVA Board is authorized by the TVA Act to set rates for power sold to its customers, TVA is self-regulated. Additionally, TVA's regulated rates are designed to recover its costs. Based on current projections, TVA believes that rates, set at levels that will recover TVA's costs, can be charged and collected. As a result of these factors, TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferral of gains that will be credited to customers in future periods. TVA assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, potential legislation, and changes in technology. Based on these assessments, TVA believes the existing regulatory assets are probable of future recovery. This determination reflects the current regulatory and political environment and is subject to change in the future. If future recovery of regulatory assets ceases to be probable, or any of the other factors described above cease to be applicable, TVA would no longer be considered to be a regulated entity and would be required to write off these costs. Most regulatory asset write offs would be required to be recognized in earnings in the period in which future recovery ceases to be probable.

Basis of Presentation

TVA prepares its consolidated interim financial statements in conformity with GAAP for consolidated interim financial information. Accordingly, TVA's consolidated interim financial statements do not include all of the information and notes required by GAAP for annual financial statements. As such, they should be read in conjunction with the audited financial statements for the year ended September 30, 2015, and the notes thereto, which are contained in TVA's Annual Report on Form 10-K for the year ended September 30, 2015 (the “Annual Report”). In the opinion of management, all adjustments (consisting of items of a normal recurring nature) considered necessary for fair presentation are included in the interim financial statements.

The accompanying consolidated interim financial statements include the accounts of TVA and three variable interest entities ("VIEs"), of which TVA is the primary beneficiary. See Note 7. Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements requires TVA to estimate the effects of various matters that are inherently uncertain as of the date of the consolidated financial statements. Although the consolidated financial statements are prepared in conformity with GAAP, TVA is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the amounts of revenues and expenses reported during the reporting period. Each of these estimates varies in regard to the level of judgment involved and its potential impact on TVA's financial results. Estimates are deemed critical either when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period and such use or change would materially impact TVA's financial condition, results of operations, or cash flows.

Reclassifications

Certain historical amounts have been reclassified in the Consolidated Statements of Cash Flows for the three months ended December 31, 2014. Amounts previously presented in Cash flows from operating activities as Environmental cleanup costs – Kingston ash spill – non cash of $12 million and Environmental cleanup costs – Kingston ash spill of $(9) million for the three months ended December 31, 2014, are currently reported in Other, net.

In the Consolidated Balance Sheet at September 30, 2015, TVA reclassified $80 million of debt issuance costs previously presented in Other long-term assets and presented $67 million as a reduction to Long-term power bonds, net and $13 million as a reduction to Long-term debt, net of variable interest entities. See Note 2 – Debt Issuance Costs for additional information.

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Allowance for Uncollectible Accounts

The allowance for uncollectible accounts reflects TVA's estimate of probable losses inherent in its accounts and loans receivable balances. TVA determines the allowance based on known accounts, historical experience, and other currently available information including events such as customer bankruptcy and/or a customer failing to fulfill payment arrangements. It also reflects TVA's corporate credit department's assessment of the financial condition of customers and the credit quality of the receivables.

The allowance for uncollectible accounts was $1 million at both December 31, 2015 and September 30, 2015, for accounts receivable. Additionally, loans receivable of $135 million and $129 million at December 31, 2015 and September 30, 2015, respectively, are included in Accounts receivable, net and Other long-term assets, for the current and long-term portions, respectively, and reported net of allowances for uncollectible accounts of $8 million at both December 31, 2015 and September 30, 2015.

Depreciation

Depreciation expense was $364 million and $380 million for the three months ended December 31, 2015, and December 31, 2014, respectively. In September 2015, the NRC approved renewed licenses for Sequoyah Nuclear Plant ("Sequoyah") Units 1 and 2, which allow both units to operate for an additional 20 years and TVA adjusted prospectively the Sequoyah depreciation rate. These license extensions contributed to $22 million of the decrease in depreciation expense for the three months ended December 31, 2015, as compared to the three months ended December 31, 2014 as a result of this change in estimate.

Blended Low-Enriched Uranium Program

Under the blended low-enriched uranium ("BLEU") program, TVA, the U.S. Department of Energy ("DOE"), and certain nuclear fuel contractors have entered into agreements providing for the DOE's surplus of enriched uranium to be blended with other uranium down to a level that allows the blended uranium to be fabricated into fuel that can be used in nuclear power plants. Under the terms of an interagency agreement between TVA and the DOE, in exchange for supplying highly enriched uranium materials to the appropriate third-party fuel processors for processing into usable BLEU fuel for TVA, the DOE participates to a degree in the savings generated by TVA's use of this blended nuclear fuel. Over the life of the program, TVA projects that the DOE's share of savings generated by TVA's use of this blended nuclear fuel could result in payments to the DOE of as much as $162 million. TVA accrues an obligation with each BLEU reload batch related to the portion of the ultimate future payments estimated to be attributable to the BLEU fuel currently in use. At December 31, 2015, TVA had paid out approximately $131 million for this program, and the obligation recorded was $12 million.

2. Impact of New Accounting Standards and Interpretations

The following accounting standard was adopted by TVA on October 1, 2015.

Debt Issuance Costs. In April 2015, the Financial Accounting Standards Board ("FASB") issued guidance that changes the presentation of debt issuance costs in financial statements. This standard requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct reduction of that debt liability, consistent with debt discounts, including retrospectively adjusting all prior periods presented. TVA early adopted the standard on October 1, 2015. In the Consolidated Balance Sheets at December 31, 2015, TVA reclassified $80 million of debt issuance costs previously presented in Other long-term assets on the September 30, 2015 Consolidated Balance Sheets and presented these amounts as a reduction to Long-term power bonds, net and Long-term debt, net of variable interest entities. The guidance does not change the recognition and measurement of debt issuance costs.

The following accounting standards have been issued, but as of December 31, 2015, were not effective and had not been adopted by TVA.

Revenue Recognition. In May 2014, the FASB issued a new revenue recognition standard that applies to revenue from contracts with customers. The standard requires that an entity recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued a one-year deferral of the effective date. The standard becomes effective for TVA on October 1, 2018, and allows for either a full retrospective or a modified retrospective application. Early adoption of the standard is permitted for TVA on October 1, 2017. TVA is currently evaluating the potential impact of these changes on its consolidated financial statements and related disclosures and the application method to be used.

Consolidation. In February 2015, the FASB issued guidance that amends the consolidation analysis for VIEs as well as voting interest entities. The standard reduces the number of consolidation models through the elimination of the indefinite deferral for certain entities that was previously allowed and places more emphasis on risk of loss when determining a controlling financial interest. The standard becomes effective for TVA on October 1, 2016, and allows for either a full retrospective or a

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modified retrospective application. TVA has evaluated the impact of adopting this guidance and expects no material impact on TVA's financial condition, results of operations, or cash flows.

Inventory Valuation. In July 2015, the FASB issued guidance that changes the model used for the subsequent measurement of inventory from the previous lower of cost or market model, to the lower of cost or net realizable value. The guidance applies only to inventory valued using methods other than last-in, first out or the retail inventory method (for example, first-in, first-out or average cost). This amendment is intended to simplify the subsequent measurement of inventory. The standard becomes effective for TVA on October 1, 2017, including interim periods within the fiscal year that begins on that date, and is required to be applied prospectively. Early adoption is permitted. TVA is currently evaluating the potential impact of these changes on its consolidated financial statements.

3. Accounts Receivable, Net

Accounts receivable primarily consist of amounts due from customers for power sales. The table below summarizes the types and amounts of TVA's accounts receivable:

Accounts Receivable, Net

	At December 31, 2015	At September 30, 2015
Power receivables	$1,165	$1,509
Other receivables	75	92
Allowance for uncollectible accounts	(1)	(1)
Accounts receivable, net	$1,239	$1,600

4. Inventories, Net

The table below summarizes the types and amounts of TVA's inventories:

Inventories, Net

	At December 31, 2015	At September 30, 2015
Materials and supplies inventory	$685	$651
Fuel inventory	499	414
Emission allowance inventory, net	15	13
Allowance for inventory obsolescence	(53)	(47)
Inventories, net	$1,146	$1,031

5. Other Long-Term Assets

The table below summarizes the types and amounts of TVA's other long-term assets:

Other Long-Term Assets

	At December 31, 2015	At September 30, 2015
EnergyRight® receivables	$123	$124
Loans and other long-term receivables, net	132	126
Prepaid capacity payments	50	52
Currency swap asset, net	9	25
Commodity contract derivative assets	4	1
Other	92	75
Other long-term assets	$410	$403

In association with the EnergyRight® Solutions program, local power company customers of TVA ("LPCs") offer financing to end-use customers for the purchase of energy-efficient equipment. Depending on the nature of the energy-efficiency project, loans may have a maximum term of five years or ten years. TVA purchases the resulting loans receivable from its LPCs. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the loans receivable are reported in Accounts receivable, net and Other long-term assets, respectively, on TVA's consolidated balance sheets. As of both December 31, 2015 and September 30, 2015, the carrying amount of the loans receivable, net of discount, reported in Accounts receivable, net was approximately $32 million. See Note 8 for information regarding the associated financing obligation.

6. Regulatory Assets and Liabilities

Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferrals of gains that will be credited to customers in future periods. Components of regulatory assets and regulatory liabilities are summarized in the table below:

Regulatory Assets and Liabilities

	At December 31, 2015	At September 30, 2015
Current regulatory assets		
Deferred nuclear generating units	$237	$237
Unrealized losses on commodity derivatives	169	162
Environmental agreements	49	47
Environmental cleanup costs - Kingston ash spill	43	43
Fuel cost adjustment receivable	3	15
Other current regulatory assets	2	2
Total current regulatory assets	503	506
Non-current regulatory assets		
Deferred pension costs and other post-retirement benefits costs	5,556	5,565
Unrealized losses on interest rate derivatives	1,147	1,236
Nuclear decommissioning costs	970	1,003
Environmental cleanup costs - Kingston ash spill	331	348
Non-nuclear decommissioning costs	835	828
Deferred nuclear generating units	1,004	1,042
Environmental agreements	41	55
Unrealized losses on commodity derivatives	81	63
Other non-current regulatory assets	272	278
Total non-current regulatory assets	10,237	10,418
Total regulatory assets	$10,740	$10,924
Current regulatory liabilities		
Fuel cost adjustment tax equivalents	$157	$164
Fuel cost adjustment payable	25	—
Total current regulatory liabilities	182	164
Non-current regulatory liabilities		
Unrealized gains on commodity derivatives	4	2
Total non-current regulatory liabilities	4	2
Total regulatory liabilities	$186	$166

7. Variable Interest Entities

A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of owning a controlling financial interest. When TVA determines that it has a variable interest in a variable interest entity, a qualitative evaluation is performed to assess which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and have the obligation to absorb losses or receive benefits that could be significant to the entity. The evaluation considers the purpose and design of the business, the risks that the business was designed to create and pass along to other entities, the activities of the business that can be directed and which party can direct them, and the expected relative impact of those activities on the economic performance of the business through its life. TVA has the power to direct the activities of an entity when it has the ability to make key operating and financing decisions, including, but not limited to, capital investment and the issuance of debt. Based on the evaluation of these criteria, TVA has determined it is the primary beneficiary of several entities and as such is required to account for the VIEs on a consolidated basis. See discussion following.

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John Sevier VIE

In 2012, TVA entered into a $1.0 billion construction management agreement and lease financing arrangement with John Sevier Combined Cycle Generation LLC ("JSCCG") for the completion and lease by TVA of the John Sevier Combined Cycle Facility ("John Sevier CCF"). JSCCG is a special single-purpose limited liability company formed in January 2012 to finance the John Sevier CCF through a $900 million secured note issuance (the “JSCCG notes”) and the issuance of $100 million of membership interests subject to mandatory redemption. The membership interests were purchased by John Sevier Holdco LLC ("Holdco"). Holdco is a special single-purpose entity, also formed in January 2012, established to acquire and hold the membership interests in JSCCG. A non-controlling interest in Holdco is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows is allocated.

The membership interests held by Holdco in JSCCG were purchased with proceeds from the issuance of $100 million of secured notes (the “Holdco notes") and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each January 15 and July 15, with a final payment due in January 2042. The payment dates for the mandatorily redeemable membership interests are the same as those of the Holdco notes. The sale of the JSCCG notes, the membership interests in JSCCG, and the Holdco notes closed in January 2012. The JSCCG notes are secured by TVA’s lease payments, and the Holdco notes are secured by Holdco's investment in, and amounts receivable from, JSCCG. TVA’s lease payments to JSCCG are equal to and payable on the same dates as JSCCG’s and Holdco’s semi-annual debt service payments. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by JSCCG and Holdco. Certain agreements related to this transaction contain default and acceleration provisions.

Southaven VIE

In 2013, TVA entered into a lease financing arrangement with Southaven Combined Cycle Generation LLC ("SCCG") for the lease by TVA of the Southaven Combined Cycle Facility ("Southaven CCF"). SCCG is a special single-purpose limited liability company formed in June 2013 to finance the Southaven CCF through a $360 million secured notes issuance (the “SCCG notes”) and the issuance of $40 million of membership interests subject to mandatory redemption. The membership interests were purchased by Southaven Holdco LLC ("SHLLC"). SHLLC is a special single-purpose entity, also formed in June 2013, established to acquire and hold the membership interests of SCCG. A non-controlling interest in SHLLC is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows of SHLLC are allocated.

The membership interests held by SHLLC were purchased with proceeds from the issuance of $40 million of secured notes (the "SHLLC notes") and are subject to mandatory redemption pursuant to a schedule of amortizing, semi-annual payments due each February 15 and August 15, with a final payment due on August 15, 2033. The payment dates for the mandatorily redeemable membership interests are the same as those of the SHLLC notes and the payment amounts are sufficient to provide returns on, as well as returns of, capital until the investment has been repaid to SHLLC in full. The rate of return on investment to SHLLC is 7.0 percent, which is reflected as interest expense in the consolidated statements of operations. SHLLC is required to pay a pre-determined portion of the return on investment to Seven States Southaven, LLC ("SSSL") on each lease payment date as agreed in SHLLC's formation documents (the "Seven States Return"). The current and long-term portions of the Membership interests of VIE subject to mandatory redemption are included in Accounts payable and accrued liabilities and Other long-term liabilities, respectively.

The payment dates for the mandatorily redeemable membership interests are the same as those of the SHLLC notes. The SCCG notes are secured by TVA’s lease payments, and the SHLLC notes are secured by SHLLC’s investment in, and amounts receivable from, SCCG. TVA’s lease payments to SCCG are payable on the same dates as SCCG’s and

SHLLC's semi-annual debt service payments and are equal to the sum of (i) the amount of SCCG's semi-annual debt service payments, (ii) the amount of SHLLC's semi-annual debt service payments, and (iii) the amount of the Seven States Return. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by SCCG and SHLLC. Certain agreements related to this transaction contain default and acceleration provisions.

In the event that TVA were to choose to exercise an early buy out feature of the Southaven Facility Lease, in part or in whole, TVA must pay to SCCG amounts sufficient for SCCG to repay or partially repay on a pro rata basis the membership interests held by SHLLC, including any outstanding investment amount plus accrued but unpaid return. TVA also has the right, at any time and without any early redemption of the other portions of the Southaven Facility Lease payments due to SCCG, to fully repay SHLLC's investment, upon which repayment SHLLC will transfer the membership interests to a designee of TVA.

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Impact on Consolidated Balance Sheets

The financial statement items attributable to carrying amounts and classifications of JSCCG, Holdco, and SCCG as of December 31, 2015 and September 30, 2015, as reflected in the consolidated balance sheets are as follows:

Summary of Impact of VIEs on Consolidated Balance Sheets

	At December 31, 2015	At September 30, 2015
Current liabilities of VIE		
Accrued interest of VIE	$27	$12
Current portion of membership interests of VIE subject to mandatory redemption	2	2
Current maturities of long-term debt of VIE	33	33
Total current liabilities of VIE	62	47
Other liabilities of VIE		
Membership interests of VIE subject to mandatory redemption	35	35
Long-term debt of VIE, net		
Long-term debt of VIE, net	1,233	1,233
Total liabilities of VIE	$1,330	$1,315

Creditors of the VIEs do not have any recourse to the general credit of TVA. TVA does not have any obligations to provide financial support to the VIEs other than as prescribed in the terms of the agreements related to these transactions.

8. Other Long-Term Liabilities

Other long-term liabilities consist primarily of liabilities related to certain derivative instruments as well as liabilities under agreements related to compliance with certain environmental regulations (see Note 16 — Legal Proceedings — Environmental Agreements). The table below summarizes the types and amounts of Other long-term liabilities:

Other Long-Term Liabilities

	At December 31, 2015	At September 30, 2015
Interest rate swap liabilities	$1,538	$1,627
EnergyRight® financing obligation	146	148
Environmental agreements liability	41	55
Currency swap liabilities	58	47
Membership interests of VIE subject to mandatory redemption	35	35
Commodity contract derivative liabilities	46	17
Commodity swap derivative liabilities	9	10
Other	276	280
Total other long-term liabilities	$2,149	$2,219

EnergyRight® Financing Obligation. TVA purchases certain loans receivable from its LPCs in association with the EnergyRight® Solutions program. The current and long-term portions of the resulting financing obligation are reported in Accounts payable and accrued liabilities and Other long-term liabilities, respectively, on TVA's consolidated balance sheets. As of both December 31, 2015 and September 30, 2015, the carrying amount of the financing obligation reported in Accounts payable and accrued liabilities was approximately $37 million. See Note 5 for information regarding the associated loans receivable and for details regarding the EnergyRight® Solutions program.

9. Asset Retirement Obligations

During the three months ended December 31, 2015, TVA's total ARO liability increased $8 million.

To estimate its decommissioning obligation related to its nuclear generating stations, TVA uses a probability-weighted, discounted cash flow model which, on a unit-by-unit basis, considers multiple outcome scenarios that include significant estimations and assumptions. Those assumptions include (1) estimates of the cost of decommissioning, (2) the method of decommissioning and the timing of the related cash flows, (3) the license period of the nuclear plant, considering the probability of license extensions, (4) cost escalation factors, and (5) the credit adjusted risk free rate to measure the obligation at the present value of the future estimated costs. TVA has ascribed probabilities to two different decommissioning methods related to its nuclear decommissioning obligation estimate: the DECON method and the SAFESTOR method. The DECON method

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requires radioactive contamination to be removed from a site and safely disposed of or decontaminated to a level that permits the site to be released for unrestricted use shortly after it ceases operation. The SAFSTOR method allows nuclear facilities to be placed and maintained in a condition that allows the facilities to be safely stored and subsequently decontaminated to levels that permit release for unrestricted use.

TVA bases its nuclear decommissioning estimates on site-specific cost studies. These studies will be updated for each of TVA's nuclear units at least every 5 years and were most recently performed in 2014.

In April 2015, the EPA published its final rule governing coal combustion residuals, which regulates landfill and impoundment location, design, and operations; dictates certain pond-closure conditions; and establishes groundwater monitoring and closure and post-closure standards. As a result of these rules, TVA recorded certain adjustments to its ARO liabilities in 2015. TVA continues to evaluate the impact of the rule on its operations, including cost and timing estimates of related projects. As a result, further adjustments to its ARO liabilities may be required as estimates are refined.

During the three months ended December 31, 2015, both the nuclear and non-nuclear liabilities were increased by periodic accretion, partially offset by settlement projects that were conducted during these periods. The nuclear and non-nuclear accretion amounts were deferred as regulatory assets. During the three months ended December 31, 2015, $36 million of the related regulatory assets were amortized into expense as these amounts were collected in rates. See Note 6. TVA maintains investment trusts to help fund its decommissioning obligations. See Note 13 and Note 16 — Contingencies — Decommissioning Costs for a discussion of the trusts' objectives and the current balances of the trusts.

Asset Retirement Obligation Activity

	Nuclear	Non-Nuclear	Total
Balance at September 30, 2015	$2,187	$1,656	$3,843
Settlements	—	(22)	(22)
Change in estimate	—	(7)	(7)
Accretion (recorded as regulatory asset)	26	11	37
Balance at December 31, 2015	$2,213	$1,638	$3,851 (1)

Note
(1) The current portion of ARO in the amount of $183 million is included in Accounts payable and accrued liabilities at December 31, 2015.

10. Debt and Other Obligations

Debt Outstanding

Total debt outstanding at December 31, 2015, and September 30, 2015, consisted of the following:

Debt Outstanding

	At December 31, 2015	At September 30, 2015
Short-term debt		
Short-term debt, net	$1,504	$1,034
Current maturities of long-term debt of variable interest entities	33	33
Current maturities of power bonds	554	32
Total current debt outstanding, net	2,091	1,099
Long-term debt		
Long-term debt of variable interest entities	1,246	1,246
Long-term power bonds[1]	22,242	22,792
Unamortized discounts, premiums, issue costs, and other	(184)	(188)
Total long-term debt, net	23,304	23,850
Total outstanding debt	$25,395	$24,949

Note
(1) Includes net exchange gain from currency transactions of $44 million at December 31, 2015 and $21 million at September 30, 2015.

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Debt Securities Activity

The table below summarizes the long-term debt securities activity for the period from October 1, 2015, to December 31, 2015:

Debt Securities Activity

	Date	Amount	Interest Rate	
Redemptions/Maturities				
electronotes®	First Quarter 2016	$1	2.65	%
2009 Series A	November 2015	2	2.25	%
2009 Series B	December 2015	1	3.77	%
Total redemptions/maturities of power bonds		4		
Total redemptions/maturities of debt		$4		

Note
(1) All redemptions were at 100 percent of par.

Credit Facility Agreements

TVA and the U.S. Treasury, pursuant to the TVA Act, have entered into a memorandum of understanding under which the U.S. Treasury provides TVA with a $150 million credit facility. This credit facility was renewed for 2016 with a maturity date of September 30, 2016. Access to this credit facility or other similar financing arrangements with the U.S. Treasury has been available to TVA since the 1960s. TVA can borrow under the U.S. Treasury credit facility only if it cannot issue Bonds in the market on reasonable terms, and TVA considers the U.S. Treasury credit facility a secondary source of liquidity. The interest rate on any borrowing under this facility is based on the average rate on outstanding marketable obligations of the United States with maturities from date of issue of one year or less. There were no outstanding borrowings under the facility at December 31, 2015. The availability of this credit facility may be impacted by how the U.S. government addresses the situation of approaching its debt limit.

TVA also has funding available in the form of three long-term revolving credit facilities totaling $2.5 billion. The $500 million credit facility matures on February 1, 2020, one $1.0 billion credit facility matures on June 2, 2020, and another $1.0 billion credit facility matures on September 30, 2020. The interest rate on any borrowing under these facilities varies based on market factors and the rating of TVA's senior unsecured long-term non-credit-enhanced debt. TVA is required to pay an unused facility fee on the portion of the total $2.5 billion that TVA has not borrowed or committed under letters of credit. This fee, along with letter of credit fees, may fluctuate depending on the rating of TVA's senior unsecured long-term non-credit-enhanced debt. At both December 31, 2015 and September 30, 2015, there were $1.1 billion of letters of credit outstanding under the facilities, and there were no borrowings outstanding. See Note 12 — Other Derivative Instruments — Collateral.

The following table provides additional information regarding TVA's funding available in the form of three long-term credit facilities:

Summary of Long-Term Credit Facilities
At December 31, 2015
(in billions)

Maturity Date	Facility Limit	Letters of Credit Outstanding	Cash Borrowings	Availability
February 2020	$0.5	$0.5	$—	$—

June 2020	1.0	0.3	—	0.7
September 2020	1.0	0.3	—	0.7
Total	$2.5	$1.1	$—	$1.4

Lease/Leaseback Obligations

Prior to 2004, TVA received approximately $945 million in proceeds by entering into lease/leaseback transactions for 24 new peaking combustion turbine units. TVA also received approximately $389 million in proceeds by entering into lease/leaseback transactions for qualified technological equipment and software in 2003. Due to TVA's continuing involvement in the operation and maintenance of the leased units and equipment and its control over the distribution of power produced by the combustion turbine facilities during the leaseback term, TVA accounted for the lease proceeds as financing obligations. At both December 31, 2015, and September 30, 2015, the outstanding lease/leaseback obligations were $616 million.

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11. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) ("AOCI") represents market valuation adjustments related to TVA's currency swaps. The currency swaps are cash flow hedges and are the only derivatives in TVA's portfolio that have been designated and qualify for hedge accounting treatment. TVA records exchange rate gains and losses on its foreign currency-denominated debt in net income and marks its currency swap assets and liabilities to market through other comprehensive income (loss) ("OCI"). TVA then reclassifies an amount out of AOCI into net income, offsetting the exchange gain/loss recorded on the debt. During the three months ended December 31, 2015 and 2014, TVA reclassified $24 million and $38 million of losses, respectively, related to its cash flow hedges from AOCI to Interest expense.

TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. As such, certain items that would generally be reported in AOCI or that would impact the statements of operations are recorded as regulatory assets or regulatory liabilities.

See Note 6 for a schedule of regulatory assets and liabilities. See Note 12 for a discussion of the recognition in AOCI of gains and losses associated with certain derivative contracts. See Note 13 for a discussion of the recognition of certain investment fund gains and losses as regulatory assets and liabilities. See Note 15 for a discussion of the regulatory accounting related to components of TVA's benefit plans.

12. Risk Management Activities and Derivative Transactions

TVA is exposed to various risks. These include risks related to commodity prices, investment prices, interest rates, currency exchange rates, and inflation as well as counterparty credit and performance risks. To help manage certain of these risks, TVA has entered into various derivative transactions, principally commodity option contracts, forward contracts, swaps, swaptions, futures, and options on futures. Other than certain derivative instruments in its trust investment funds, it is TVA's policy to enter into these derivative transactions solely for hedging purposes and not for speculative purposes. TVA plans to continue to manage fuel price volatility through various methods, but is currently evaluating the future use of financial instruments.

Overview of Accounting Treatment

TVA recognizes certain of its derivative instruments as either assets or liabilities on its consolidated balance sheets at fair value. The accounting for changes in the fair value of these instruments depends on (1) whether TVA uses regulatory accounting to defer the derivative gains and losses, (2) whether the derivative instrument has been designated and qualifies for hedge accounting treatment, and (3) if so, the type of hedge relationship (for example, cash flow hedge).

The following tables summarize the accounting treatment that certain of TVA's financial derivative transactions receive:

Summary of Derivative Instruments That Receive Hedge Accounting Treatment (part 1)

Amount of Mark-to-Market Gain (Loss) Recognized in OCI

Derivatives in Cash Flow Hedging Relationship	Objective of Hedge Transaction	Accounting for Derivative Hedging Instrument	Three Months Ended December 31 2015	2014
Currency swaps			$(27)	$(15)

	To protect against changes in cash flows caused by changes in foreign currency exchange rates (exchange rate risk)	Unrealized gains and losses are recorded in AOCI and reclassified to interest expense to the extent they are offset by gains and losses on the hedged transaction

Summary of Derivative Instruments That Receive Hedge Accounting Treatment (part 2)

Amount of Gain (Loss) Reclassified from OCI to Interest Expense		
	Three Months Ended December 31	
Derivatives in Cash Flow Hedging Relationship	2015	2014
Currency swaps	$(24)	$(38)

Note
There were no ineffective portions or amounts excluded from effectiveness testing for any of the periods presented. Based on forecasted foreign currency exchange rates, TVA expects to reclassify approximately $44 million of losses from AOCI to interest expense within the next twelve months to offset amounts anticipated to be recorded in interest expense related to exchange gain on the debt.

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Summary of Derivative Instruments That Do Not Receive Hedge Accounting Treatment
Amount of Gain (Loss) Recognized in Income on Derivatives

			Three Months Ended December 31(1)	
Derivative Type	Objective of Derivative	Accounting for Derivative Instrument	2015	2014
Interest rate swaps	To fix short-term debt variable rate to a fixed rate (interest rate risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses are recognized in interest expense when payments are made or received on the swap settlement dates.	$(28)	$(29)
Commodity contract derivatives	To protect against fluctuations in market prices of purchased coal or natural gas (price risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses due to contract settlements are recognized in fuel expense as incurred.	—	—
Commodity derivatives under financial trading program ("FTP")	To protect against fluctuations in market prices of purchased commodities (price risk)	Mark-to-market gains and losses are recorded as regulatory assets or liabilities. Realized gains and losses are recognized in fuel expense or purchased power expense when the related commodity is used in production.	(36)	(14)

Notes
(1) All of TVA's derivative instruments that do not receive hedge accounting treatment have unrealized gains (losses) that would otherwise be recognized in income
but instead are deferred as regulatory assets and liabilities. As such, there was no related gain (loss) recognized in income for these unrealized gains (losses) for the three months ended December 31, 2015 and 2014.

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Fair Values of TVA Derivatives

	At December 31, 2015			At September 30, 2015		
Derivatives That Receive Hedge Accounting Treatment	Balance		Balance Sheet Presentation	Balance		Balance Sheet Presentation
Currency swaps						
£200 million Sterling	$(43	)	Other long-term liabilities	$(41	)	Other long-term liabilities
£250 million Sterling	9		Other long-term assets	25		Other long-term assets
£150 million Sterling	(15	)	Other long-term liabilities	(6	)	Other long-term liabilities

	At December 31, 2015			At September 30, 2015		
Derivatives That Do Not Receive Hedge Accounting Treatment	Balance		Balance Sheet Presentation	Balance		Balance Sheet Presentation
Interest rate swaps						
$1.0 billion notional	(1,115	)	Other long-term liabilities	(1,177	)	Other long-term liabilities
$476 million notional	(412	)	Other long-term liabilities	(438	)	Other long-term liabilities
$42 million notional	(11	)	Other long-term liabilities	(12	)	Other long-term liabilities
Commodity contract derivatives	(138	)	Other long-term assets $4; Other long-term liabilities $(46); Accounts payable and accrued liabilities $(96)	(97	)	Other long-term assets $1; Other long-term liabilities $(17); Accounts payable and accrued liabilities $(81)
FTP						
Derivatives under FTP(1)	(101	)	Other current assets $(80); Other long-term liabilities $(9); Accounts payable and accrued liabilities $(12)	(116	)	Other current assets $(89); Other long-term liabilities $(10); Accounts payable and accrued liabilities $(17)

Note
(1) Fair values of certain derivatives under the FTP that were in net liability positions totaling $80 million and $89 million at December 31, 2015 and September 30, 2015, respectively, are recorded in TVA's margin cash accounts in Other current assets. These derivatives are transacted with futures commission merchants, and cash deposits have been posted to the margin cash accounts held with each futures commission merchant to offset the net liability positions in full.

Cash Flow Hedging Strategy for Currency Swaps

To protect against exchange rate risk related to three British pound sterling denominated Bond transactions, TVA entered into foreign currency hedges at the time the Bond transactions occurred. TVA had the following currency swaps outstanding as of December 31, 2015:

Currency Swaps Outstanding
At December 31, 2015

Effective Date of Currency Swap Contract	Associated TVA Bond Issues Currency Exposure	Expiration Date of Swap	Overall Effective Cost to TVA

1999	£200 million	2021	5.81%
2001	£250 million	2032	6.59%
2003	£150 million	2043	4.96%

When the dollar strengthens against the British pound sterling, the exchange gain on the Bond liability is offset by an exchange loss on the swap contract. Conversely, when the dollar weakens against the British pound sterling, the exchange loss on the Bond liability is offset by an exchange gain on the swap contract. All such exchange gains or losses on the Bond liability are included in Long-term debt, net. The offsetting exchange losses or gains on the swap contracts are recognized in AOCI. If any gain (loss) were to be incurred as a result of the early termination of the foreign currency swap contract, the resulting income (expense) would be amortized over the remaining life of the associated Bond as a component of Interest expense.

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Derivatives Not Receiving Hedge Accounting Treatment

Interest Rate Derivatives. TVA uses regulatory accounting treatment to defer the mark-to-market ("MtM") gains and losses on its interest rate swaps. The net deferred unrealized gains and losses are classified as regulatory assets or liabilities on TVA's consolidated balance sheets and are included in the ratemaking formula when the transactions settle. The values of these derivatives are included in Other long-term assets or Other long-term liabilities on the consolidated balance sheets, and realized gains and losses, if any, are included in TVA's consolidated statements of operations. For the three months ended December 31, 2015 and 2014, the changes in fair market value of the interest rate swaps resulted in deferred unrealized gains (losses) of $89 million and $(184) million, respectively.

Commodity Derivatives. TVA enters into certain derivative contracts for coal and natural gas that require physical delivery of the contracted quantity of the commodity. TVA marks to market all such contracts and defers the fair market values as regulatory assets or liabilities on a gross basis. At December 31, 2015, TVA's coal and natural gas contract derivatives both had terms of up to 3 years.

Commodity Contract Derivatives

	At December 31, 2015			At September 30, 2015		
	Number of Contracts	Notional Amount	Fair Value (MtM)	Number of Contracts	Notional Amount	Fair Value (MtM)
Coal contract derivatives	12	20 million tons	$(123)	14	19 million tons	$(98)
Natural gas contract derivatives	30	132 million mmBtu	$(15)	33	134 million mmBtu	$1

Derivatives Under FTP. While TVA is currently evaluating the use of financial instruments for price hedging, certain natural gas swaps with a maturity of two years or less remain as part of the suspended FTP. The FTP is designed to allow TVA to purchase and sell futures, swaps, options, and combinations of these instruments (as long as they are standard in the industry) to hedge TVA's exposure to (1) the price of natural gas, fuel oil, electricity, coal, emission allowances, nuclear fuel, and other commodities included in TVA's fuel cost adjustment calculation, (2) the price of construction materials, and (3) contracts for goods priced in or indexed to foreign currencies. The combined transaction limit for the fuel cost adjustment and construction material transactions is $130 million (based on one-day value at risk). In addition, the maximum hedge volume for the construction material transactions is 75 percent of the underlying net notional volume of the material that TVA anticipates using in approved TVA projects, and the market value of all outstanding hedging transactions involving construction materials is limited to $100 million at the execution of any new transaction. The portfolio value at risk limit for the foreign currency transactions is $5 million and is separate and distinct from the $130 million transaction limit discussed above. TVA's policy prohibits trading financial instruments under the FTP for speculative purposes.

Derivatives Under Financial Trading Program

	At December 31, 2015		At September 30, 2015	
	Notional Amount	Fair Value (MtM) (in millions)	Notional Amount	Fair Value (MtM) (in millions)
Natural gas (in mmBtu)				
Swap contracts	40,977,500	$(101)	51,495,000	$(116)

Note
Fair value amounts presented are based on the net commodity position with the counterparty. Notional amounts disclosed represent the net absolute value of contractual amounts.

TVA defers all FTP unrealized gains (losses) as regulatory liabilities (assets) and records only realized gains or losses to match the delivery period of the underlying commodity. In addition to the open commodity derivatives disclosed above, TVA had closed derivative contracts with market values of $(6) million at December 31, 2015, and $(11) million at September 30, 2015. TVA experienced the following unrealized and realized gains and losses related to the FTP at the dates and during the periods, as applicable, set forth in the tables below:

Financial Trading Program Unrealized Gains (Losses)

	At December 31, 2015	At September 30, 2015
FTP unrealized gains (losses) deferred as regulatory liabilities (assets)		
Natural gas	$(101)	$(116)

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Financial Trading Program Realized Gains (Losses)

	For the Three Months Ended December 31	
	2015	2014
Decrease (increase) in fuel expense		
Natural gas	$(29)	$(12)
Fuel oil/crude oil	—	1

Financial Trading Program Realized Gains (Losses)

	For the Three Months Ended December 31	
	2015	2014
Decrease (increase) in purchased power expense		
Natural gas	$(7)	$(3)

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Offsetting of Derivative Assets and Liabilities

The amounts of TVA's derivative instruments as reported in the Consolidated Balance Sheets as of December 31, 2015, and September 30, 2015, are shown in the table below:

Derivative Assets and Liabilities

	As of December 31, 2015		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Balance Sheet [1]	Net Amounts of Assets/Liabilities Presented in the Balance Sheet [2]
Assets			
Currency swap(s)[3][4]	$9	$—	$9
Commodity derivatives under FTP	36	(36)	—
Total derivatives subject to master netting or similar arrangement	45	(36)	9
Total derivatives not subject to master netting or similar arrangement	4	—	4
Total	$49	$(36)	$13
Liabilities			
Currency swap(s) [4]	$58	$—	$58
Interest rate swaps [4]	1,538	—	1,538
Commodity derivatives under FTP	137	(116)	21
Total derivatives subject to master netting or similar arrangement	1,733	(116)	1,617
Total derivatives not subject to master netting or similar arrangement	142	—	142
Total	$1,875	$(116)	$1,759

	As of September 30, 2015		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Balance Sheet [1]	Net Amounts of Assets/Liabilities Presented in the Balance Sheet [2]
Assets			
Currency swap(s)[3][4]	$25	$—	$25
Commodity derivatives under FTP	49	(49)	—
Total derivatives subject to master netting or similar arrangement	74	(49)	25
Total derivatives not subject to master netting or similar arrangement	1	—	1
Total	$75	$(49)	$26
Liabilities			
Currency swap(s) [4]	$47	$—	$47

Interest rate swaps [4]	1,627	—	1,627
Commodity derivatives under FTP	165	(138)	27
Total derivatives subject to master netting or similar arrangement	1,839	(138)	1,701
Total derivatives not subject to master netting or similar arrangement	98	—	98
Total	$1,937	$(138)	$1,799

Notes

(1) Amounts primarily include counterparty netting of derivative contracts, margin account deposits for futures commission merchants transactions, and cash collateral received or paid in accordance with the accounting guidance for derivatives and hedging transactions.

(2) There are no derivative contracts subject to a master netting arrangement or similar agreement which are not offset in the balance sheets.

(3) At December 31, 2015 and September 30, 2015, there were no securities posted by a counterparty on TVA's behalf to partially secure the asset position(s) of currency swaps in accordance with the collateral requirements for these derivatives.

(4) Letters of credit of approximately $1.1 billion were posted as collateral at both December 31, 2015 and September 30, 2015, to partially secure the liability positions of one of the currency swaps and one of the interest rate swaps in accordance with the collateral requirements for these derivatives. TVA held $20 million and $15 million cash collateral in excess of collateral requirements at December 31, 2015 and September 30, 2015, respectively. Cash collateral held in excess of collateral requirements is recorded in Restricted cash and investments with a corresponding obligation of the same amount recorded in Accounts payable and accrued liabilities.

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Other Derivative Instruments

Investment Fund Derivatives. Investment funds consist primarily of funds held in the Nuclear Decommissioning Trust ("NDT"), the Asset Retirement Trust ("ART"), the Supplemental Executive Retirement Plan ("SERP"), and the Long-Term Deferred Compensation Plan ("LTDCP"). All securities in the trusts are classified as trading. See Note 13 — Investment Funds for a discussion of the trusts' objectives and the types of investments included in the various trusts. These trusts may invest in derivative instruments which may include swaps, futures, options, forwards, and other instruments. At December 31, 2015 and September 30, 2015, the NDT held investments in forward contracts to purchase debt securities. The fair values of these derivatives were in net liability positions totaling $8 million and $59 million at December 31, 2015 and September 30, 2015, respectively.

At December 31, 2015 and September 30, 2015, the fair value of other derivative instruments in these trusts was not material to TVA's consolidated financial statements.

Collateral. TVA's interest rate swaps and currency swaps contain contract provisions that require a party to post collateral (in a form such as cash or a letter of credit) when the party's liability balance under the agreement exceeds a certain threshold. At December 31, 2015, the aggregate fair value of all derivative instruments with credit-risk related contingent features that were in a liability position was $1.6 billion. TVA's collateral obligations at December 31, 2015, under these arrangements were approximately $1.1 billion, for which TVA had posted approximately $1.1 billion in letters of credit. These letters of credit reduce the available balance under the related credit facilities. TVA's assessment of the risk of its nonperformance includes a reduction in its exposure under the contract as a result of this posted collateral.

For all of its derivative instruments with credit-risk related contingent features:

- If TVA remains a majority-owned U.S. government entity but Standard & Poor's Financial Services, LLC ("S&P") or Moody's Investors Service, Inc. ("Moody's") downgrades TVA's credit rating to AA or Aa2, respectively, TVA's collateral obligations would likely increase by $22 million and

- If TVA ceases to be majority-owned by the U.S. government, TVA's credit rating would likely be downgraded and TVA would be required to post additional collateral.

Counterparty Credit Risk

Credit risk is the exposure to economic loss that would occur as a result of a counterparty's nonperformance of its contractual obligations. Where exposed to counterparty credit risk, TVA analyzes the counterparty's financial condition prior to entering into an agreement, establishes credit limits, monitors the appropriateness of those limits, as well as any changes in the creditworthiness of the counterparty on an ongoing basis, and employs credit mitigation measures, such as collateral or prepayment arrangements and master purchase and sale agreements, to mitigate credit risk.

Credit of Customers. The majority of TVA's counterparty credit risk is associated with trade accounts receivable from delivered power sales to LPCs, all located in the Tennessee Valley region. To a lesser extent, TVA is exposed to credit risk from industries and federal agencies directly served and from exchange power arrangements with a small number of investor-owned regional utilities related to either delivered power or the replacement of open positions of longer-term purchased power or fuel agreements. TVA had concentrations of revenue from six LPCs that accounted for 32 percent of total operating revenue for both the three months ended December 31, 2015 and the three months ended December 31, 2014.

Credit of Derivative Counterparties. TVA has entered into physical and financial contracts that qualify as derivatives for hedging purposes, and TVA's NDT fund and qualified defined benefit pension plan have entered into derivative contracts for investment purposes. If a counterparty to one of TVA's hedging transactions defaults, TVA might incur substantial costs in connection with entering into a replacement hedging transaction. If a counterparty to the derivative contracts into which the NDT fund and the pension plan have entered for investment purposes defaults, the value of the investment could decline significantly or perhaps become worthless. TVA has concentrations of credit risk from the banking and coal industries because multiple companies in these industries serve as counterparties to TVA in various derivative transactions. At December 31, 2015, all of TVA's currency swaps, interest rate swaps, and commodity derivatives under the FTP were with banking counterparties whose Moody's credit rating was Baa1 or higher.

TVA classifies qualifying forward coal contracts as derivatives. At December 31, 2015, these contracts were with suppliers whose Moody's credit rating, or TVA’s internal analysis when such information was unavailable, ranged from Ca to Baa3. Emerging technologies, environmental regulations, and low gas prices have contributed to weak demand for coal. As a result, coal suppliers are facing increased financial pressure which has led to relatively poor credit ratings and bankruptcies. Continued difficulties by coal suppliers could result in consolidations, additional bankruptcies, restructuring, contract renegotiations, or other scenarios. Under these scenarios and TVA’s potential available responses, TVA does not anticipate a significant financial impact in obtaining continued fuel supply for its coal-fired generation. TVA does not have any derivative contracts with coal counterparties in an asset position as of December 31, 2015. See Derivatives Not Receiving Hedge Accounting Treatment above.

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TVA currently utilizes two futures commission merchants ("FCMs") to clear commodity contracts, including futures, options, and similar financial derivatives. These transactions are executed under the FTP by the FCMs on exchanges on behalf of TVA. TVA maintains margin cash accounts with the FCMs. TVA makes deposits to the margin cash accounts to adequately cover any net liability positions on its derivatives transacted with the FCMs. See the note to the Fair Values of TVA Derivatives table above.

Credit of Suppliers. If one of TVA's fuel or purchased power suppliers fails to perform under the terms of its contract with TVA, TVA might lose the money that it paid to the supplier under the contract and have to purchase replacement fuel or power on the spot market, perhaps at a significantly higher price than TVA was entitled to pay under the contract. In addition, TVA might not be able to acquire replacement fuel or power in a timely manner and thus might be unable to satisfy its own obligations to deliver power. To help ensure a reliable supply of coal, TVA had coal contracts with multiple suppliers at December 31, 2015. The contracted supply of coal is sourced from multiple geographic regions of the United States and is to be delivered via various transportation methods (for example, barge, rail, and truck). Nuclear fuel requirements including uranium mining and milling, conversion services, enrichment services, and fabrication services are met from various suppliers, depending on type of service. TVA purchases the majority of its natural gas requirements from a variety of suppliers under short-term contracts.

TVA has a power purchase agreement that expires on March 31, 2032, with a supplier of electricity for 440 megawatts ("MW") of summer net capability from a lignite-fired generating plant. TVA has determined that the supplier has the equivalent of a non-investment grade credit rating; therefore, the supplier has provided credit assurance to TVA under the terms of the agreement.

13. Fair Value Measurements

Fair value is determined based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the asset or liability's principal market, or in the absence of a principal market, the most advantageous market for the asset or liability in an orderly transaction between market participants. TVA uses market or observable inputs as the preferred source of values, followed by assumptions based on hypothetical transactions in the absence of market inputs.

Valuation Techniques

The measurement of fair value results in classification into a hierarchy by the inputs used to determine the fair value as follows:

Level 1	—	Unadjusted quoted prices in active markets accessible by the reporting entity for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing.
Level 2	—	Pricing inputs other than quoted market prices included in Level 1 that are based on observable market data and that are directly or indirectly observable for substantially the full term of the asset or liability. These include quoted market prices for similar assets or liabilities, quoted market prices for identical or similar assets in markets that are not active, adjusted quoted market prices, inputs from observable data such as interest rate and yield curves, volatilities and default rates observable at commonly quoted intervals, and inputs derived from observable market data by correlation or other means.
Level 3	—	Pricing inputs that are unobservable, or less observable, from objective sources. Unobservable inputs are only to be used to the extent observable inputs are not available. These inputs maintain the concept of an exit price from the perspective of a

market participant and should reflect assumptions of other market participants. An entity should consider all market participant assumptions that are available without unreasonable cost and effort. These are given the lowest priority and are generally used in internally developed methodologies to generate management's best estimate of the fair value when no observable market data is available.

A financial instrument's level within the fair value hierarchy (where Level 3 is the lowest and Level 1 is the highest) is based on the lowest level of input significant to the fair value measurement.

The following sections describe the valuation methodologies TVA uses to measure different financial instruments at fair value. Except for gains and losses on SERP and LTDCP assets, all changes in fair value of these assets and liabilities have been recorded as changes in regulatory assets, regulatory liabilities, or AOCI on TVA's consolidated balance sheets and consolidated statements of comprehensive income (loss). Except for gains and losses on SERP and LTDCP assets, there has been no impact to the consolidated statements of operations or the consolidated statements of cash flows related to these fair value measurements.

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Investment Funds

At December 31, 2015, Investment funds were composed of $2.1 billion of securities classified as trading and measured at fair value and less than $1 million of equity investments not required to be measured at fair value. Trading securities are held in the NDT, ART, SERP, and LTDCP. The NDT holds funds for the ultimate decommissioning of TVA's nuclear power plants. The ART holds funds primarily for the costs related to the future closure and retirement of TVA's other long-lived assets. The balances in the NDT and ART were $1.5 billion and $449 million, respectively, at December 31, 2015.

TVA established a SERP for certain executives in critical positions to provide supplemental pension benefits tied to compensation that exceeds limits set by Internal Revenue Service rules applicable to the qualified defined benefit pension plan. The LTDCP is designed to provide long-term incentives to executives to encourage them to stay with TVA and to provide competitive levels of total compensation to such executives. The NDT and SERP are invested in securities generally designed to achieve a return in line with overall equity market performance, and the ART and LTDCP are invested in securities generally designed to achieve a return in line with overall debt and equity market performance.

The NDT, ART, SERP, and LTDCP are composed of multiple types of investments and are managed by external institutional managers. Most U.S. and international equities, Treasury inflation-protected securities, real estate investment trust securities, and cash securities and certain derivative instruments are measured based on quoted exchange prices in active markets and are classified as Level 1 valuations. Fixed-income investments, high-yield fixed-income investments, currencies, and most derivative instruments are non-exchange traded and are classified as Level 2 valuations. These measurements are based on market and income approaches with observable market inputs.

Private partnership investments may include holdings of investments in private real estate, venture capital, buyout, mezzanine or subordinated debt, restructuring or distressed debt, and special situations through funds managed by third-party investment managers. Investments in private partnerships generally involve a three-to-four-year period where the investor contributes capital. This is followed by a period of distribution, typically over several years. The investment period is generally, at a minimum, ten years or longer. The NDT had unfunded commitments related to private partnerships of $79 million at December 31, 2015. These investments have no redemption or limited redemption options and may also have imposed restrictions on the NDT's ability to liquidate its investment. There are no readily available quoted exchange prices for these investments. The fair value of the investments is based on TVA's ownership percentage of the fair value of the underlying investments as provided by the investment managers. These investments are typically valued on a quarterly basis. TVA's private partnership investments are valued at net asset values ("NAV") as a practical expedient for fair value. TVA classifies its interest in these types of investments as investments measured at net asset value in the fair value hierarchy.

Commingled funds represent investment funds comprising multiple individual financial instruments. The commingled funds held by the NDT, ART, SERP, and LTDCP consist of either a single class of securities, such as equity, debt, or foreign currency securities, or multiple classes of securities. All underlying positions in these commingled funds are either exchange traded or measured using observable inputs for similar instruments. The fair value of commingled funds is based on NAV per fund share (the unit of account), derived from the prices of the underlying securities in the funds. These commingled funds can be redeemed at the measurement date NAV and are classified as investments measured at net asset value in the fair value hierarchy.

Realized and unrealized gains and losses on trading securities are recognized in current earnings and are based on average cost. The gains and losses of the NDT and ART are subsequently reclassified to a regulatory asset or liability account in accordance with TVA's regulatory accounting policy. See Note 1 — Cost-Based Regulation. TVA recorded unrealized gains and losses related to its trading securities held as of the end of each period as follows:

Unrealized Investment Gains (Losses)

	Financial Statement Presentation	For the Three Months Ended December 31 2015	2014
SERP	Other income (expense)	$—	$(1)
LTDCP	Other income (expense)	—	(1)
NDT	Regulatory asset	39	23
ART	Regulatory asset	12	6

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Currency and Interest Rate Swaps

See Note 12 — Cash Flow Hedging Strategy for Currency Swaps and Derivatives Not Receiving Hedge Accounting Treatment for a discussion of the nature, purpose, and contingent features of TVA's currency swaps and interest rate swaps. These swaps are classified as Level 2 valuations and are valued based on income approaches using observable market inputs for similar instruments.

Commodity Contract Derivatives and Commodity Derivatives Under FTP

Commodity Contract Derivatives. Most of these contracts are valued based on market approaches which utilize short- and mid-term market-quoted prices from an external industry brokerage service. A small number of these contracts are valued based on a pricing model using long-term price estimates from TVA's coal price forecast. To value the volume option component of applicable coal contracts, TVA uses a Black-Scholes pricing model which includes inputs from the forecast, contract-specific terms, and other market inputs. These contracts are classified as Level 3 valuations.

Commodity Derivatives Under FTP. These contracts are valued based on market approaches which utilize Chicago Mercantile Exchange ("CME") quoted prices and other observable inputs. Futures and options contracts settled on the CME are classified as Level 1 valuations. Swap contracts are valued using a pricing model based on CME inputs and are subject to nonperformance risk outside of the exit price. These contracts are classified as Level 2 valuations.

See Note 12 — Derivatives Not Receiving Hedge Accounting Treatment — Commodity Derivatives and — Derivatives Under FTP for a discussion of the nature and purpose of coal contracts and derivatives under TVA's FTP.

Nonperformance Risk

The assessment of nonperformance risk, which includes credit risk, considers changes in current market conditions, readily available information on nonperformance risk, letters of credit, collateral, other arrangements available, and the nature of master netting arrangements. TVA is a counterparty to currency swaps, interest rate swaps, commodity contracts, and other derivatives which subject TVA to nonperformance risk. Nonperformance risk on the majority of investments and certain exchange-traded instruments held by TVA is incorporated into the exit price that is derived from quoted market data that is used to mark the investment to market.

Nonperformance risk for most of TVA's derivative instruments is an adjustment to the initial asset/liability fair value. TVA adjusts for nonperformance risk, both of TVA (for liabilities) and the counterparty (for assets), by applying credit valuation adjustments ("CVAs"). TVA determines an appropriate CVA for each applicable financial instrument based on the term of the instrument and TVA's or the counterparty's credit rating as obtained from Moody's. For companies that do not have an observable credit rating, TVA uses internal analysis to assign a comparable rating to the company. TVA discounts each financial instrument using the historical default rate (as reported by Moody's for CY 1983 to CY 2015) for companies with a similar credit rating over a time period consistent with the remaining term of the contract. The application of CVAs resulted in a less than $1 million decrease in the fair value of assets and a $1 million decrease in the fair value of liabilities at December 31, 2015.

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Fair Value Measurements

The following tables set forth by level, within the fair value hierarchy, TVA's financial assets and liabilities that were measured at fair value on a recurring basis as of December 31, 2015, and September 30, 2015. Financial assets and liabilities have been classified in their entirety based on the lowest level of input that is significant to the fair value measurement. TVA's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the determination of the fair value of the assets and liabilities and their classification in the fair value hierarchy levels.

Fair Value Measurements
At December 31, 2015

Assets	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investments				
Equity securities	$185	$—	$—	$185
Debt securities				
U.S. government corporations and agencies	200	39	—	239
Corporate debt securities	—	254	—	254
Residential mortgage-backed securities	—	16	—	16
Commercial mortgage-backed securities	—	5	—	5
Collateralized debt obligations	—	28	—	28
Institutional mutual funds	88	—	—	88
Forward debt securities contracts	—	(8)	—	(8)
Private partnerships measured at net asset value[1]	—	—	—	245
Commingled funds measured at net asset value[1]	—	—	—	1,031
Total investments	473	334	—	2,083
Currency swap(s) [2]	—	9	—	9
Commodity contract derivatives	—	4	—	4
Commodity derivatives under FTP[2]				
Swap contracts	—	—	—	—
Total	$473	$347	$—	$2,096

Liabilities	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Currency swap(s) [2]	$—	$58	$—	$58
Interest rate swaps	—	1,538	—	1,538
Commodity contract derivatives	—	19	123	142

Commodity derivatives under FTP[2]				
Swap contracts	—	21	—	21
Total	$—	$1,636	$123	$1,759

Notes
(1) Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.
(2) Due to the right of setoff and method of settlement, TVA elects to record commodity derivatives under the FTP based on its net commodity position with the counterparty or FCM. Deposits are made to TVA's margin cash accounts held with each FCM to offset any net liability positions in full for derivatives that are transacted with FCMs. TVA records currency swaps net of cash collateral received from or paid to the counterparty, to the extent such amount is not recorded in Accounts payable and accrued liabilities. See Note 12 — Offsetting of Derivative Assets and Liabilities.

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Fair Value Measurements
At September 30, 2015

Assets	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investments				
Equity securities	$166	$—	$—	$166
Debt securities				
U.S. government corporations and agencies	203	31	—	234
Corporate debt securities	—	225	—	225
Residential mortgage-backed securities	—	17	—	17
Commercial mortgage-backed securities	—	7	—	7
Collateralized debt obligations	—	29	—	29
Institutional mutual funds	91	—	—	91
Forward debt securities contracts	—			