



## Memorandum

To: ISO Governing Board and Market Participants  
From: Randy Abernathy, VP Market Services, William Regan, CFO and Michael Epstein, Controller  
Date: December 16, 2004  
Re: **Issuance of SAS 70 Audit on ISO Bid-to-Bill Process**

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The ISO has just issued a SAS 70 Type 2 audit (SAS 70) for the twelve-month period from November 1, 2003 to October 31, 2004. The SAS 70 is a report by PricewaterhouseCoopers, our independent auditor (auditor), on the effectiveness of the ISO's internal controls over its bid-to-bill process for the audit-period, for the use of the ISO's market participants and their auditors. The term, "SAS 70" derives from the auditing profession's Statement on Auditing Standards No. 70, "Reports on the Processing of Transactions by Service Organizations". The ISO would come under the definition of a service organization with respect to its market participants.

The SAS 70 provides our market participants assurance that the ISO has sufficient internal controls over the processes and procedures that lead to the charges on ISO market participants' invoices for market and Grid Management charges, FERC Fees, TAC refunds, and RMR billings. Many of our market participants have shares that trade on major exchanges that are governed by the Securities and Exchange Commission. They are subject to the Sarbanes-Oxley Act, which requires them to certify to the sufficiency of their own internal controls. The ISO's SAS 70 provides them that level of assurance for their reporting requirements for their participation in the ISO markets.

The auditor's opinion addresses whether the description in the SAS 70 presents fairly, in all material respects, the relevant aspects of the ISO's controls that had been placed in operation as of October 31, 2004, whether the controls were suitably designed to provide reasonable assurance that the specified control objectives would be achieved if those controls were complied with satisfactorily, and whether the specific controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the related control objectives were achieved for the period November 1, 2003 to October 31, 2004.

Control objectives (objectives) are the highest level of controls described of which the ISO has identified thirty-nine that comprise the bid-to-bill process. The objectives are grouped into three main categories: global processes such as Scheduling and Bidding, charge type or business processes such as Unaccounted-for-Energy and Information Systems processes.

For a given objective there is a portfolio of control activities (activities) that the ISO performs to achieve that control objective. The ISO has implemented 319 activities to assure attainment of the thirty-nine objectives. The auditor reviews and tests these 319 activities to determine the effectiveness in achieving the objectives. All activities for a given objective must be functioning to achieve that objective.

An example may be helpful in understanding the process. The global process of Scheduling and Bidding is comprised of two objectives, and ten activities are utilized to achieve those two objectives; two activities for the first objective and eight activities for the second.

Thus for Scheduling and Bidding, the first objective and its two related activities are as follows:

- **Objective:** *Controls are in place to provide reasonable assurance that only certified SCs are authorized to participate in the ISO markets.*
- **First Activity:** *SCs qualifications are reviewed and approved prior to the SC being certified to participate in the ISO markets*
- **Second Activity:** *A checklist is used to track all necessary steps that need to be performed by the SC applicants and approved by various ISO departments prior to certification of the SC by the ISO. Representatives from these departments sign the checklist, signifying that their requirements have been completed. Once all required signatures have been obtained, a manager of Client Relations reviews and signs the checklist signifying that all steps have been completed and the SC applicant can be entered into the ISO systems and considered certified.*

The auditor's opinion states that thirty-seven of the thirty-nine objectives, comprising 285 activities, were operating effectively for the period. Phase 1B of the ISO's Market Redesign and Technology Upgrade (MRTU) was implemented on October 1, 2004 in the last month of the audit. Two Phase 1B activities were determined to have process errors, which were corrected in November prior to the issuance of market participants' preliminary settlement statements. These two activities are components of a portfolio of thirty-six activities that are required to achieve two objectives, which are Real Time Dispatch and OOS/OOM Settlements. Although the remaining thirty-four activities were operating effectively, this condition resulted in the auditors qualifying their opinion as of October 31, 2004 with respect to these two objectives. In summary, 317 activities out of the total of 319 activities were operating effectively.

The specific condition related to the interface between two systems: the Real Time Market Application (RTMA) and Scheduling Infrastructure (SI) application. When SI was brought back on-line after being down, the data in SI was not updated for RTMA data generated during the down time. If not identified, this condition would more likely have resulted in MW errors versus price errors, and would likely have been identified in the market participant review of their preliminary settlement statements. As described in Section 5 of the report, during November 2004, subsequent to the close of the audit but prior to issuance of market participants' settlement statements for October, the ISO reviewed all situations when the SI application went down, and made corrections as appropriate. Furthermore, additional control activities have now been put in place to prevent this condition from recurring. Thus no errors were reflected on market participants' settlement statements.

As described in Section 5 other changes were also made to Settlements and Market Operations in November to reflect changes arising from the implementation of Phase 1B. Additionally, there are several other findings in the report, primarily in the RMR and IS Security areas, but which did not constitute a qualification in meeting the control objectives.

The ISO's control environment reflects the overall attitude, awareness, commitment and actions of the ISO's Board, management, and other stakeholders concerning the importance of control and its emphasis in the entity. The activities underlying the bid-to-bill process are constantly reviewed for improvement opportunities. Conditions noted in the current report have been addressed and new processes are being implemented to make the activities more efficient and effective. The components of MRTU address the control environment and process improvement. Continuous improvement is a priority at the ISO.