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Results of the 2010 Financial Statement Audit

Board of Governors' Meeting

Folsom, CA

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Presenter
Roger Mills

Agenda

Results of audit

Description of financial statements

Key audit areas

Financial reporting comparisons

Independence

Required communications

Closing

Results of audit

- Audits are complete
  - Audit reports issued
  - Two sets of financial statements
    - General purpose – GAAP
    - Statutory – FERC
  - ISO Management prepared the financial statements
  - PwC audited the financial statements
- The ISO's audit opinions are unqualified
- No material weaknesses or significant deficiencies identified in internal controls
- Audits were completed on time and on budget
- Form and content of the financial statements are similar to prior years

Corporate financial statements

- General purpose use
  - Annual report
  - Financial users
- Basis of accounting – State and Local Government (GASB)
  - Required based on state government board appointment process
  - Differs from private accounting principles – some investments; benefit plans
- Audit comments
  - These are primary; prepared first
  - Audit is focused on these – over 90% of audit effort

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California Independent System Operator Corporation

Financial Statements

For the years ending December 31, 2010 and 2009

FERC Form #1 Financial Statements

- Statutory
  - Filed with FERC
  - Available to public through FERC
- Basis of Accounting – FERC Chart of accounts
  - Basic accounting follows normal private accounting principles (FASB)
  - Statutory forms
- Audit comments
  - These are less reader friendly
  - Less audit focus/ leverage primary audit
  - Net difference - $1.6 million impact to income/loss in 2010

FERC FINANCIAL REPORT
FERC FORM No. 1: Annual Report of Major Electric Utilities, Licensees and Others and Supplemental Form 3-Q: Quarterly Financial Report

FERC vs. GASB reporting

- Differences in net income/ loss from corporate (general purpose) financial statements
  - Investments - all at fair value under FERC, most under fair value for corporate (MTM gain of $1.3 million for FERC)
  - Post employment medical plan - different actuarial valuation under FERC ($0.3 million lower expense for FERC)
  - Net loss - $1.6 million lower loss for FERC than corporate
- Significant differences between corporate and FERC financial statement footnotes
  - Generally reduced disclosures, no requirement for MD&A
  - Additional fair value disclosures
  - Additional schedules required by FERC (unaudited)

Key audit areas

Generator noncompliance fines:

- Initially imposed in 2000/2001
- Adjusted in 2002 and 2004, based on updated information and estimates - no adjustments from 2005 to 2008 except interest accruals
- In 2009, the ISO recognized $12.8 million as a reduction of interest expense and the related liability (result of May 2009 FERC Ruling), and an additional $900k was recognized in 2010
- ISO made a distribution related to the liability during 2010 of $43.9 million.
- Remaining liability recorded at the end of 2010 is $800k
- Disclosure of significant uncertainties associated with estimate
- Management believes it is unlikely there will be any further reductions in fine revenue

Key audit areas

Contingencies:

- Exposure to ISO comes from three sources
  - Market based adjustments; disputed charges
  - GMC could be contingent
  - Non market issues - corporate exposure as employer
- Key Assertion
  - Management believes any settlements would likely be resettled against the ISO's markets (not from the ISO)
  - Therefore, no recorded liabilities regarding these market matters
- Disclosures include
  - Refund case stemming from energy crisis
  - Market disputes in Good Faith Negotiations (GFN)

Key audit areas

Old headquarters facilities:

- Determination of date the exit obligation should be recorded – 2011 (substantial cease use date)
- Disclosure in financial statements of estimated future exit costs - $5.9 million
- Financial impacts of acceleration on other related assets (leaseholds and other assets at old HQ facility) was taken in prior years

New headquarters building:

- Accounting for costs associated with the new building
  - Capitalized $ 120.o million in development and construction costs
  - Capitalized $ 10.4 million of interest
  - Total capitalized for the new building through 2010 – $130.4 million
- A portion of the building (the Mission Critical Wing) was placed in service in 2010
- Accounting for solar panel agreement at the new HQ building - accounted for as an operating lease

Financial reporting – ISO/ RTO

CAISO is one of seven operating ISO/RTO organizations operating in the U.S (most data is 2010).

	Tariff/GMC Revenues ($ in millions)	Total Assets ($ in millions)
Midwest ISO	$259	$644
ERCOT	252	818
PJM Interconnection	245	1,134
CAISO	**202**	**932**
NYISO	135	522
ISO New England	127	625
Southwest Power Pool	86	178

Financial Reporting – ISO/ RTO

High level overview of financial reporting characteristics:

- **Market Activity –** All operate energy, capacity and other markets for their market participants; each ISO/RTO has uniqueness to its market rules; in all cases such market activity is generally not reflected in their financial statements
- **FERC Jurisdiction –** All file FERC Form 1 financials, except ERCOT which is under PUC Texas jurisdiction
- **Non-profit Organization –** All are 501(c)3 or 501(c)4. PJM has limited for-profit operations
- **Financial Reporting –** All except CAISO report under private sector GAAP. CAISO reports under GASB
- **Audit Coverage –** All have annual financial statements audited; and all have SAS70/SSAE16 performed annually for their market controls

Independence

- Key element of audit relationship
- Numerous core processes in place to monitor compliance with PwC independence rules
  - Annual compliance
  - Annual training
  - Firm monitoring
- Individual audit independence and objectivity is manifested in numerous ways
  - Strict Partner rotation requirements
    - more rigorous then AICPA rules
    - average rotation for financial statement audit has been 5 years
    - numerous partners involved in ISO audits each year
  - Quality review partner role
  - Risk management oversight procedures
  - Each individual verified independence on each engagement

Required communications

There were no:

- Disagreements with Management
- Significant issues discussed prior to retention
- Significant difficulties encountered during the audit
- Material fraud or illegal acts
- Related party transactions, except as disclosed in the notes to the financial statements

Audit adjustments:

- There were no posted audit adjustments
- There were no uncorrected errors

Required communications

Internal controls:

- Scope of audit does not include an opinion on internal controls
- This differs from SAS 70/ SSAE 16 audit that we perform over market systems
- During audit we are required to report to the Audit Committee any
  - Material weaknesses
  - Significant deficiencies
- No material weaknesses or significant deficiencies were identified
- Level of audit adjustments is an indicator of potential control issues; there were none
- We have shared controls related observations and recommendations with management in context of continuous improvement

Closing

- We are independent of the ISO and have no relationships with the ISO that would impair our independence
- High level of commitment and cooperation of accounting and other staff greatly appreciated
- PwC encourages communication and feedback from the Audit Committee
- Questions