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California Independent System Operator Corporation
Report to the Audit Committee of the Board of Governors May 2014

Audit Committee Meeting

Folsom, CA

May 29, 2014

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Agenda

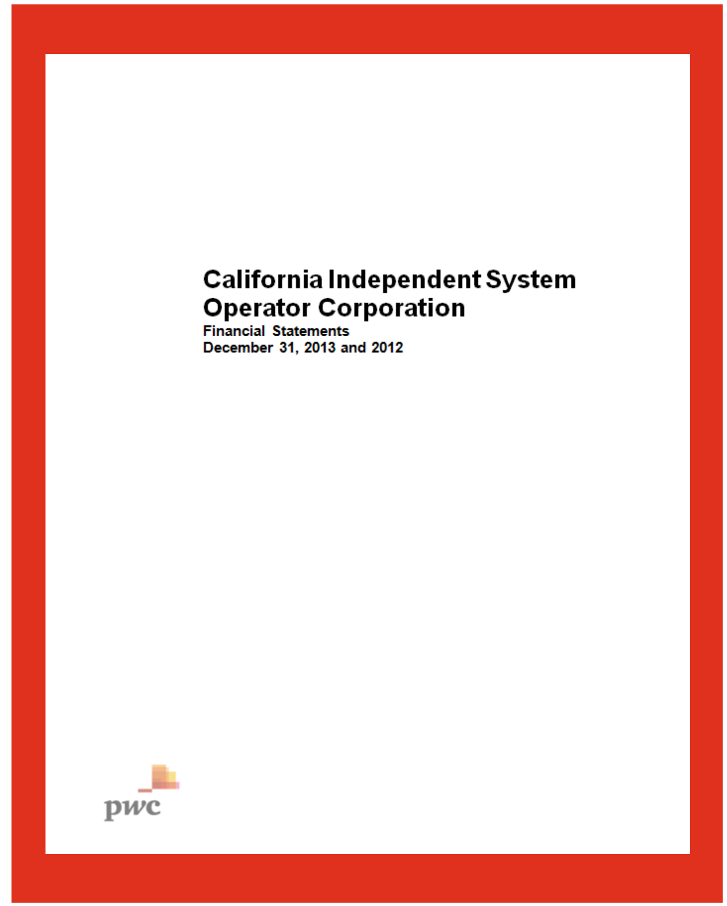
- Results of audit
- Description of financial statements
- Key audit areas
- Required communications
- Independence
- Closing

Results of audit

- Audits are complete
  - Audit reports have been issued
  - Two sets of financial statements
    - General purpose – GAAP
    - Statutory – FERC
  - ISO Management prepared the financial statements
  - PwC audited the financial statements
- The PwC audit opinions are standard and unqualified
- 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 the primary statements; prepared first
  - Audit is focused on these statements– over 90% of audit effort


California Independent System Operator Corporation
Financial Statements
December 31, 2013 and 2012

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FERC Form #1 financial statements

- Statutory
  - Filed with FERC
  - Available to public through FERC
- Basis of Accounting – FERC Uniform System of Accounts
  - Basic accounting generally follows normal private accounting principles (FASB)
  - Statutory forms
- Audit comments
  - Focus on statutory reporting requirements/leverage primary audit
  - Net difference - $.5 million

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 ($2.2 million lower investment income for FERC)
  - Post-employment medical plan - different actuarial valuation under FERC ($0.3 million lower expense for FERC)
  - Debt - different treatment of debt issuance costs under FERC ($1.4 million lower expense for FERC)
  - Net loss - $.5 million higher loss for FERC than corporate

FERC vs GASB reporting, continued

- 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

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 Representation
  - Management believes any settlements would likely be resettled against the ISO's markets (not from the ISO) except as it relates to the September 8th event
  - In 2013, management recorded a $2 million liability based on Management's assessment that a liability is probable to resolve the September 8th event
- Disclosures include:
  - Refund case stemming from energy crisis, Market disputes and September 8th events

Key audit areas, continued

Other key audit areas:

- Determination of fair value for non-traded investments
- Risk of management override of controls – presumed risk (not ISO specific)
- Cash held for market participants and related liabilities
- Long-term debt refinancing transaction
- Fixed assets, and related depreciation
- GMC revenues

Required communications

There were no:

- Significant changes to the planned audit strategy or the significant risks initially identified
- Disagreements with Management
- Significant issues discussed prior to retention
- Significant difficulties encountered during the audit
- Identified irregularities, frauds or illegal acts
- Related party transactions, except as disclosed in the notes to the financial statements

Audit adjustments:

- One adjustment to the financial statements was identified during the performance of our audit procedures and relates to an out-of-period correction to depreciation expense
- There were no uncorrected errors

Required communications, continued

Internal controls:

- Scope of audit does not include an opinion on internal controls, which differs from SSAE 16 audit that we perform over market systems
- We are required to report to the Audit Committee any
  - Material weaknesses
  - Significant deficiencies
- No material weaknesses were identified during the course of our audit procedures; however, we have identified a significant deficiency in internal control over financial reporting related to the out-of-period depreciation adjustment.
- We have shared controls related observations and recommendations with management in the context of continuous improvement

Required communications, continued

Other topics:

- Auditor's responsibility
- Significant accounting policies
- Management judgments and accounting estimates
- Significant risks and exposures
- Material uncertainties related to events and conditions
- Other information in documents containing reviewed financial information
- Consultations with other accountants
- Other material written communications
- Other matters

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
  - Partner rotation requirements for ISO are more strict than required
  - Risk management oversight procedures
  - All individuals verify independence for each engagement

Closing

- The audits were completed on time and in accordance with our plan.
- High level of commitment and cooperation of accounting and other staff is greatly appreciated
- PwC encourages communication and feedback from the Audit Committee

Questions?