



Memorandum

To: Audit Committee of the ISO Board of Governors
From: Ryan Seghesio, Chief Financial Officer and Treasurer
Date: December 11, 2017
Re: **Acceptance of market controls audit**

This memorandum requires Committee action.

EXECUTIVE SUMMARY

On December 8, 2017, the California ISO issued its market controls audit report, *the SSAE 18 Audit, (previously known as the SSAE 16 Type 2 Audit, see explanation below)*, for the period of October 1, 2016 to September 30, 2017, and subsequently provided it to the ISO Board of Governors, Management and market participants.

The market controls audit assures market participants that the ISO has sufficient internal controls over the processes and procedures of market participant charges and credits, which account for market and congestion revenue rights charges and credits, grid management charges, Federal Energy Regulatory Commission fees, transmission access charges and refunds, and reliability must-run billings.

The auditor's unqualified opinion essentially states that the internal control structure is effectively designed to provide adequate controls and that, based on their testing, the controls are in fact operating as designed. Although one exception was noted, management assessments determined impact was mitigated by other control activities and there was no impact on the effectiveness of the controls. Therefore, the control environment was operating effectively during the audit period.

Management recommends the following motion:

Moved, that the Audit Committee of the ISO Board of Governors accepts the audit report of the SSAE 18 for the period October 1, 2016 to September 30, 2017 as audited by PriceWaterhouseCoopers LLP Certified Public Accountants, as attached to the memorandum dated December 11, 2017.

BACKGROUND

The term SSAE derives from the auditing profession's Statement on Standards for Attestation Engagements, *Reports on the Processing of Transactions by Service Organizations*. When service organizations such as the ISO receive a System and Organization Controls Report (SOC 1) it is performed under the "SSAE 16 Reporting on Controls at a Service Organization" standard. In April 2016, AICPA's Auditing Standards Board (ASB) completed their "Clarity Project," the result of which was the issuance of the SSAE 18 standard. This update (from SSAE 16 to 18) became effective in 2017 and is intended to address concerns over the clarity, length, and complexity of the ASB's standards, and to further allow the ASB to converge its standards with those of the International Auditing and Assurance Standards Board.

Actual changes required by the ISO (as a service organization) and PwC (as independent auditors) to prepare for the SOC 1 are not extensive under SSAE 18. Please see below:

1. **Vendor Management-** the ISO must ensure that its vendor management program for subservice providers (for example co-location facilities) is significantly robust.
2. **Risk Assessment-** SSAE 18 requires auditors to obtain a more in-depth understanding of the development of the subject matter than currently required, in order to better identify the risks of material misstatement in an audit engagement. This, in turn, should lead to an improved linkage between assessed risks and the nature, timing, and extent of attestation procedures performed in response to those risks.
3. **Complementary Subservice Organization Controls-**In order to recognize that more organizations are outsourcing key functions to their own set of third party vendors, SSAE 18 introduces the concept of "complementary Subservice Organization" controls. This concept establishes and defines the controls for which user entities must now assume in the design of the system description. Previously, under SSAE 16, service organizations provided a listing of controls that should be performed by third party vendors.
4. **Written Assertion Requirement-** the final change to the audit report, per SSAE 18, is that the auditors obtain a written assertion. This written assertion is the statement found within the audit report wherein the ISO asserts that the system description provided is essentially true and complete. This statement has always been contained within the report document but the requirement that the service organization signs the document was previously optional. In practice, the majority of service organizations have already been signing this document, as a way to strengthen the credibility of the report. Accordingly, there will not be significant change to what either the ISO or auditors have to do to meet this requirement.

The ISO is defined as a service organization with respect to its market participants because

market participants utilize the financial information produced by the ISO market billing systems in their own financial systems. As part of the market controls audit, the ISO's independent auditor, PwC, audits the effectiveness of the internal controls related to the ISO bid-to-bill process. Many ISO market participants are publicly traded companies governed by the Securities and Exchange Commission. They are subject to the *Sarbanes-Oxley Act*, which requires them to certify the sufficiency of their own internal controls. The ISO's market controls audit report allows them to comply with these reporting requirements for participating in the ISO market.

The market controls audit report follows the standard reporting structure for internal control reports. The report contains an assertion by Management that the control environment is effectively designed and that it operated effectively during the period. The report also contains a description of the high-level organizational control environment and a structured presentation of each of our key internal control activities that are organized around twelve control objectives. There are sixty key control activities supporting the control objectives which contain the auditors' testing and their results. An exception in an activity can be noted by an auditor and, if not otherwise mitigated by other control activities, can lead to a qualification of the control objective.

Although one exception was noted for one control objective, based on assessment of the facts and circumstances, it had no impact on the effectiveness of the controls.

- The control objective with an exception in one of its activities was control objective 7, which states that controls provide reasonable assurance that charge components for energy and capacity quantities and prices are calculated accurately and completely. There are eight separate control activities that support this objective.

The control activity with an exception was 7.5: One out of a sample of twenty-five corrections selected for testing did not have evidence of review. Subsequently, an additional sample of twenty-five corrections was selected for testing and no other exceptions were noted. Management reviewed this one occurrence and found it to be an isolated case.

CONCLUSION

The market controls audit report is a comprehensive report covering the ISO's control environment. The report excludes certain activities that are not subject to this control structure, such as the quality of meter data received from market participants and control room decision-making processes.

The ISO control environment reflects the overall viewpoint, awareness, commitment and actions of the Board, Management, and market participants. Management constantly reviews activities underlying the bid-to-bill process for improvement opportunities, with process improvement as one of our top priorities.