

***California ISO audit of the  
financial statements for  
the year ending  
December 31, 2016***

*Audit Committee  
General Session  
December 15, 2016*

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# ***Agenda***

**Governance and audit communications**

**Audit strategy**

**Audit timing**

**Perspectives on fraud risk and responsibilities**

**Independence**

**Other required communications**

**Other audit related services**

**Closing**

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# ***Governance and audit communications***

## **Our audit objectives**

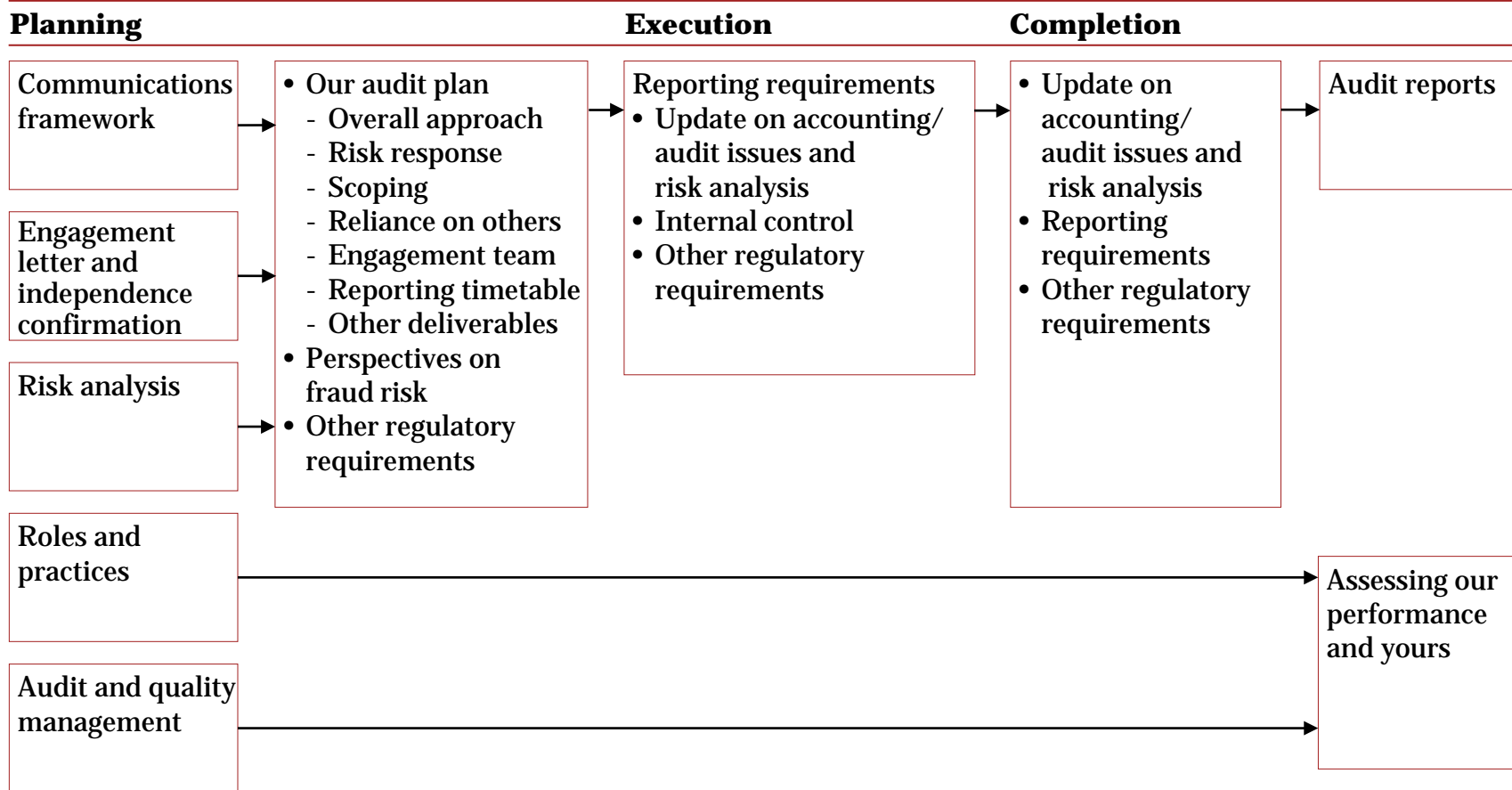
Our audit of the ISO's 2016 financial statements is directed towards delivering assurance at three levels:

- Independent opinions and reports that add credibility to financial statements released by the ISO
  - Annual financial statements (general purpose)
  - FERC Form 1 financial statements
- Assistance to the audit committee in discharging their corporate governance and compliance responsibilities
- Observations and advice on financial reporting and business issues

Our engagement letter sets out the terms of our appointment as auditors of the ISO. It also describes auditor and management responsibilities.

# Governance and audit communications (continued)

## Overview of PwC communications framework



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# ***Audit strategy***

Our audit strategy is based on the use of a top-down, risk-based approach to planning and conducting the audit:

- Gain an understanding of the business and risks
- Assessment of materiality
- Identification of audit risks and significant accounts for testing.
  - Significant audit risks – audits risks that require special audit consideration
  - Other significant accounts – largely based on materiality and/or complexity, management’s judgments and estimates
- Includes limited reliance on internal controls, but not an opinion on controls
- Excludes most financial flows in the market except for cash held on behalf of market participants

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# ***Audit strategy (continued)***

## **Significant risks and key audit areas**

### **Significant risks**

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Management override of controls – fraud risk

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### **Key audit areas**

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Legal contingencies

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Cash and cash equivalents

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Investments

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Fixed assets

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Due to market participants

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Debt

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GMC revenues

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## ***Audit strategy*** (continued)

### **Use of specialists**

During the course of the audit, we will utilize our functional experts to evaluate key areas of your business. These specialists support our core assurance team with skills necessary to achieve our audit objectives.

The following specialists, including examples of procedures to be performed include:

**Process assurance** – Testing segregation of duties (SOD) as it relates to the journal entry process in the Company’s Oracle system.

**Global human resource services** – Assessing the reasonableness of assumptions selected by management and methods employed by experts in computing the liability of the Retiree Medical Plan.

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## ***Audit strategy (continued)***

### **Materiality**

We consider both quantitative and qualitative factors in our assessment of materiality. We also consider the metrics that may be used by the users of the financial statements in determining the appropriate base for calculating materiality.

We identify and assess the risk of material misstatement at:

- The overall financial statement level, and
- In relation to classes of transactions, account balances and disclosures.

Since the California ISO is a non-profit organization, overall materiality is based on reported revenues, not “net income”.



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# ***Audit timing***

## **Activity**

## **Dates**

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Audit planning and interim testing

June – November 2016

Meeting with Audit Committee

December 15, 2016

Year-end audit fieldwork

March – April 2017

Issuance of audit reports

April 2017

Report to the Audit Committee

May 2017

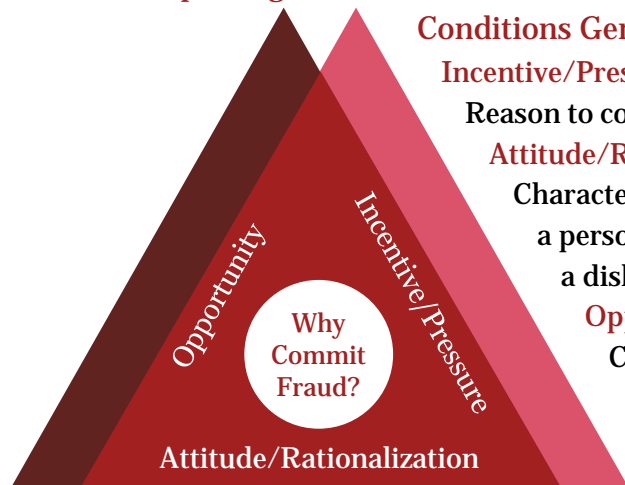
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# Perspectives on fraud risk and responsibilities

## Types of fraud

Fraudulent Financial Reporting

Misappropriation of Assets



Conditions Generally Present

**Incentive/Pressure**

Reason to commit fraud

**Attitude/Rationalization**

Character or set of ethical values that allow a person to knowingly and intentionally commit a dishonest act

**Opportunity**

Circumstances exist such as the absence of controls, ineffective controls or ability for management to override controls that allow fraud to occur

## Attributes Contributing to Increased Fraud Risk

- Size, complexity and ownership attributes of the Company
- Type, significance, likelihood and pervasiveness of the risk
- Senior Management Responsibilities
- Audit Committee Responsibilities
- Auditor Responsibilities

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# ***Independence***

With respect to the Company, we are independent accountants within the meaning of Rule 101 of the Code of Professional Conduct of the American Institute of Certified Public Accountants (“AICPA”).

There are no relationships or other matters identified that might reasonably be thought to bear on independence.

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## ***Other required communications***

- The terms of the audit engagement, including the objective of the audit and management's and our responsibilities, are set forth in our engagement letter dated August 10, 2016 (separately provided).
- There were no significant issues discussed with management prior to the retention of PwC.
- Our audit strategy does not incorporate the work of the Company's Internal Audit department.

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## ***Other related assurance services***

- **Code of Conduct Agreed Upon Procedures**
  - **Fieldwork scheduled in January 2017**
  - **Engagement consists of agreed-upon procedures and report of findings on the ISO's processes surrounding its annual certification process and related procedures for 2016 certification cycle**
  - **Report to the Board in March 2017**

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# ***Closing***

- We continue to report to and communicate directly with the Audit Committee/Board of Governors
- We are independent of the ISO and have no relationships with the ISO that would impair our independence
- PwC encourages communication and feedback from the Audit Committee
- Questions?

