

***Presentation of the  
2014 Audit Plan to  
the California ISO  
Audit Committee***

**November 13-14, 2014**

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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**

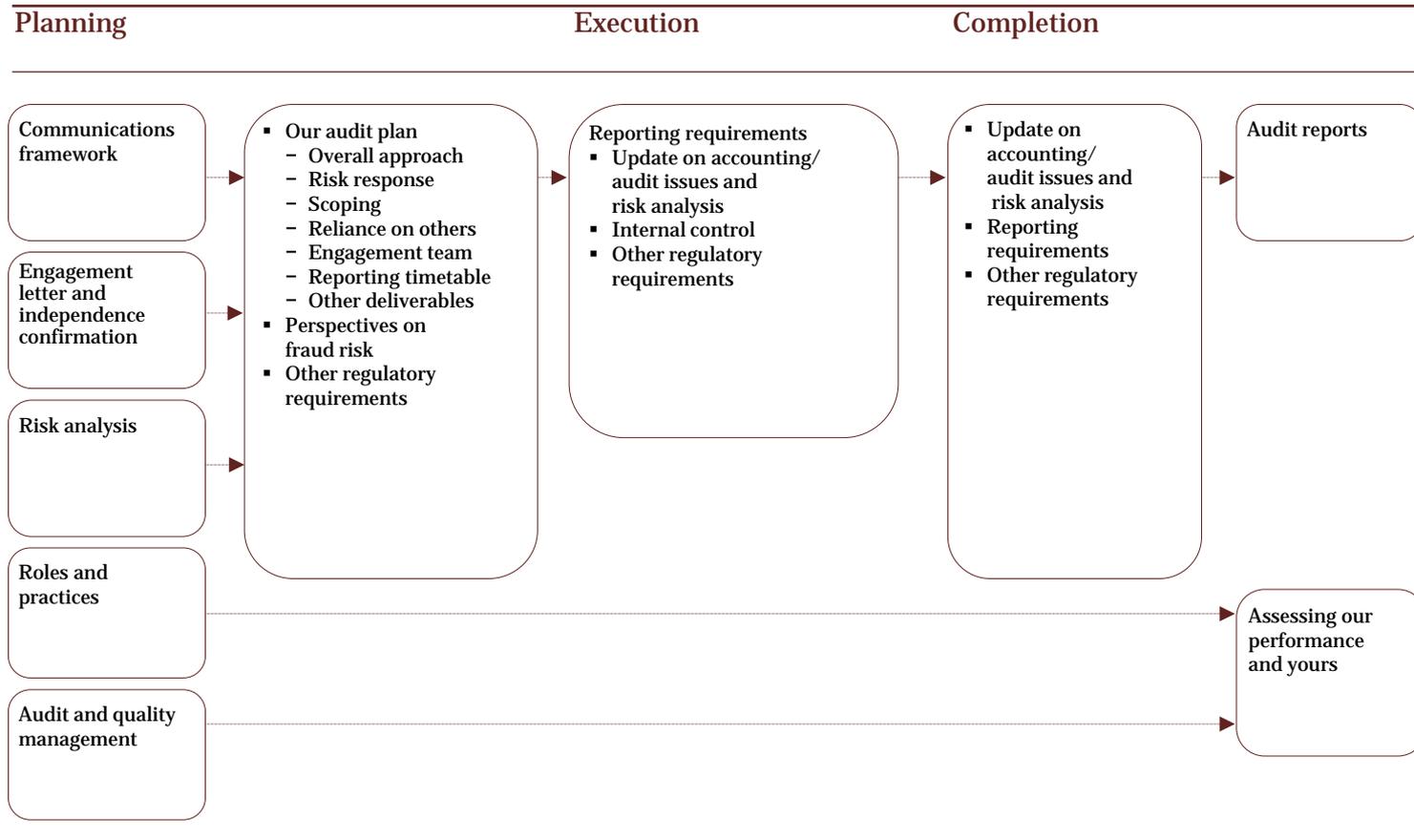
Our audit of the ISO's 2014 financial statements is directed towards delivering assurance at three levels:

- 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 and elevated 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

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

## **Key Audit Areas and Planned Procedures**

Summarized on the following slides are key audit areas and the audit procedures planned to address them:

<b>Key Audit Areas</b>	<b>PwC Audit Procedures</b>
<i>Management override of controls – fraud risk (significant risk )</i>	<ul style="list-style-type: none"><li>• Test selected journal entries, including entries created and posted by the same individual</li><li>• Understand the business rationale for all significant transactions and accounting estimates,</li><li>• Conduct fraud inquiries of management and others, and</li><li>• Design our audit approach to incorporate unpredictability.</li></ul>

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

<b>Key Audit Areas (cont)</b>	<b>PwC Audit Procedures</b>
<i>Oracle R12 implementation</i>	<ul style="list-style-type: none"><li>• Evaluate the project implementation plan and related business processes and controls impacted by the new R12 environment, and</li><li>• Perform an examination of data migration and conversion to ensure data integrity, completeness and accuracy.</li></ul>
<i>Legal contingencies</i>	<ul style="list-style-type: none"><li>• Obtain analysis of contingencies from the ISO General Counsel's office,</li><li>• Obtain legal confirmations from external counsel,</li><li>• Obtain and evaluate external correspondence or rulings related to potentially material matters (NERC and other), and</li></ul>

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

<b>Key Audit Areas</b>	<b>PwC Audit Procedures</b>
<i>Legal contingencies (continued)</i>	<ul style="list-style-type: none"><li>• Assess management's accounting conclusions (including accrual or disclosures).</li></ul>
<i>Cash and cash equivalents</i>	<ul style="list-style-type: none"><li>• Confirm bank accounts,</li><li>• Test bank reconciliations and transfers for proper cut off,</li><li>• Evaluate financial condition of depositories, and</li><li>• Assess proper classification and disclosures.</li></ul>
<i>Investments</i>	<ul style="list-style-type: none"><li>• Confirm securities held,</li><li>• Assess valuation for disclosure,</li><li>• Evaluate investments for potential impairment, and</li><li>• Test related investment income (depending on materiality)</li></ul>

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

<b>Key Audit Areas</b>	<b>PwC Audit Procedures</b>
<i>Fixed assets</i>	<ul style="list-style-type: none"><li>• Test a sample of additions and disposals (depending on materiality),</li><li>• Evaluate fixed assets for impairment,</li><li>• Test related depreciation and maintenance expenses, and</li><li>• Test accounting and disclosure of leases.</li></ul>
<i>Due to market participants</i>	<ul style="list-style-type: none"><li>• Test a sample of amounts due to market participants.</li></ul>
<i>Debt</i>	<ul style="list-style-type: none"><li>• Confirm obligations at year end,</li><li>• Test interest expense, fair value disclosures, and debt covenant compliance.</li></ul>
<i>GMC revenues</i>	<ul style="list-style-type: none"><li>• Vouch cash receipts and test unbilled accounts receivable.</li></ul>

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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 implementation of Oracle R12, and 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 financial flows, not “net income”.

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# ***Audit timing***

## **Activity**

Audit planning and interim testing

Meeting with Audit Committee

Year-end audit fieldwork

Issuance of audit reports

Report to the Audit Committee

## **Dates**

June – November 2014

November 13, 2014

March – April 2015

April 2015

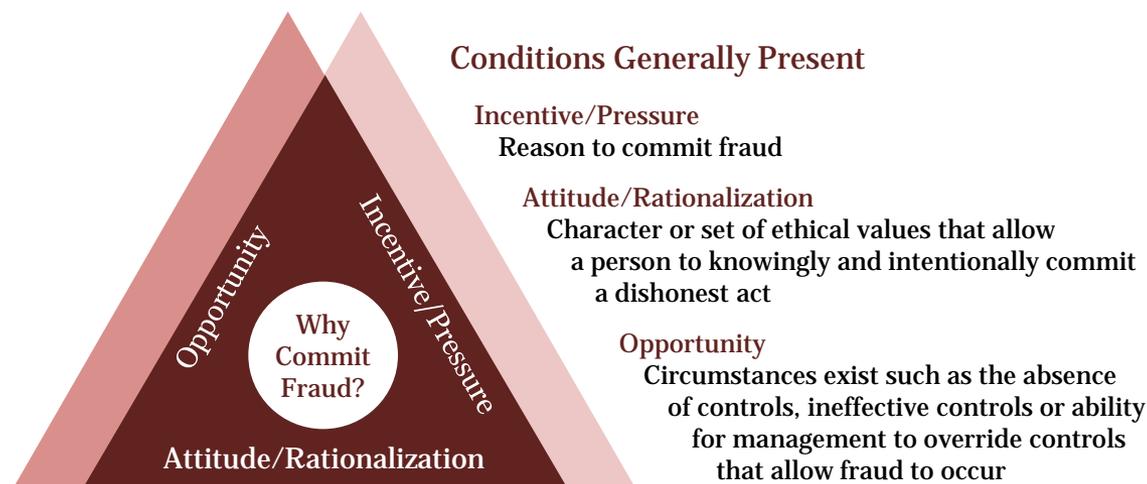
May 2015

# Perspectives on fraud risk and responsibilities

## Types of Fraud

Fraudulent Financial Reporting

Misappropriation of Assets



### 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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# ***Perspectives on fraud risk and responsibilities***

## ***(continued)***

In order to fulfill our responsibilities related to fraud, we plan to perform the following audit procedures:

- Inquiries of management, the Audit Committee, Internal Audit and others related to knowledge of fraud or suspected fraud, the fraud risk assessment process and how fraud risks are addressed by CAISO.
- Disaggregated analytical procedures, primarily over revenue.
- Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed depending on our annual assessment of fraud risk.
- Identify and select journal entries and other adjustments for testing.

Our audit approach includes an ongoing assessment of the risks of fraud throughout the audit

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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 July 22, 2014 (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 occurs in February 2015**
  - **Engagement consists of procedures and report findings on the ISO's processes surrounding annual certification process and related procedures for 2014 certification cycle**
  - **Report to the Board in March 2015**

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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?