

Memorandum

To: Audit Committee of the ISO Board of Governors

From: Ryan Seghesio, Chief Financial Officer and Treasurer

Date: May 8, 2013

Re: Acceptance of Audit of ISO Financial Statements and FERC Form 1

This memorandum requires Committee action.

EXECUTIVE SUMMARY

Management requests that the Audit Committee of the California Independent System Operator Corporation Board of Governors accept the audited financial statements and Federal Energy Regulatory Commission Form No. 1 for the years ended December 31, 2012 and 2011.

The audited financial statements and the FERC Form No. 1 were issued separately by the ISO's external auditor, PricewaterhouseCoopers, LLP on April 4, 2013 and April 17, 2013, respectively. Both audit reports were submitted to the Board electronically shortly after issuance by PricewaterhouseCoopers. Subsequently the ISO provided the audited financial statements to rating agencies in accordance with bond covenants related to outstanding debt and filed FERC Form No. 1 with FERC on April 18, 2013 to meet the regulatory deadline.

Management requests that the Audit Committee accept and recommend further Board action to accept the audited financial statements and FERC Form No. 1. The audited financial statements have been published in compliance with the ISO bylaws, and pursuant to the Corporate Governance Principles, which require the Board to ensure the prompt and appropriate reporting of the ISO's financial results.

Management recommends the following motion:

Moved, that the Audit Committee of the ISO Board of Governors accepts the financial statements of the ISO for the years ended December 31, 2012 and 2011, as audited by PricewaterhouseCoopers, and as attached to the memorandum dated May 8, 2013; and

Moved, that the Audit Committee of the ISO Board of Governors accepts the FERC Form No. 1 for the years ended December 31, 2012 and 2011, as audited by PricewaterhouseCoopers, and as attached to the memorandum dated May 8, 2013.

DISCUSSION AND ANALYSIS

Financial Statements

Management has prepared the ISO's financial statements in accordance with generally accepted accounting standards applicable for state and local governmental entities (GASB) for the years ended December 31, 2012 and 2011. Attached is an unqualified audit opinion of the financial statements issued by the ISO's external auditor, PricewaterhouseCoopers, on April 4, 2013.

The financial statements are prepared and audited in accordance with GASB because the members of the Board are appointed by the Governor of the state of California. The ISO is the only FERC jurisdictional entity reporting on a GASB basis.

FERC Form No. 1

The FERC Form No. 1 filing is an annual regulatory requirement for major electric utilities, licensees and others. This report is designed to collect financial and operational information from entities subject to FERC jurisdiction. These reports are also considered to be non-confidential public use forms.

The ISO is required to file a FERC Form No. 1 because it is considered a major electric utility, which is defined as having (1) one million megawatt hours or more; (2) 100 megawatt hours of annual sales for resale; (3) 500 megawatt hours of annual power exchange delivered; or (4) 500 megawatt hours of annual wheeling for others (deliveries plus losses). The ISO meets the criteria for both (1) and (3) above and therefore must file the FERC Form No. 1.

Management prepared the FERC Form No. 1 in accordance with FASB reporting requirements for the years ended December 31, 2012 and 2011.

Financial Reporting Differences between GASB and FERC

The FERC Form No. 1 financial statements are presented differently from the ISO GASB financial statements because FERC requires the use of Financial Accounting Standards Board ("FASB") opinions for posting of retirement benefit plans and fair value accounting for investments.

For the year ended December 31, 2012, net income under the FASB presentation is \$447,000 lower than under GASB. This is because FASB uses a higher discount rate than GASB resulting in lower annual post retirement benefit plan costs of \$100,000. FASB also recognizes the fair value of investments, (most are under fair value according to GASB) resulting in a loss of \$547,000 reported in the FERC Form No. 1. The net result of the two reporting differences is \$447,000.

FERC also uses the Uniform System of Accounts prescribed for public utilities and licensees subject to the Federal Power Act, and requires supplemental information that does not appear in the ISO GASB financial statements, as follows:

- Schedule of officers' compensation
- Additional information on functional expenses
- Additional load and transmission data

The FERC Form No. 1 also has no management discussion and analysis and it reflects less disclosure in the notes compared to the financial statements

Attached is the audit opinion of the FERC Form No. 1 issued by the external auditor PricewaterhouseCoopers on April 17, 2013.

CONCLUSION

Management respectfully requests that the Audit Committee accept the audited financial statements and FERC Form No. 1 for the years ended December 31, 2012 and 2011.