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Results of the 2011 Financial Statement Audits

Board of Governors Meeting

Folsom, CA

May 16-17, 2012

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Agenda

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

Results of audit

- Audits are complete
  - Audit reports issued
  - Two sets of financial statements
    - General purpose – GAAP
    - Statutory – FERC
  - ISO Management prepared the financial statements
  - PwC audited the financial statements
- The ISO's audit opinions are unqualified
- Audits were completed on an accelerated time frame – FERC report issued in April
- 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 primary; prepared first
  - Audit is focused on these – over 90% of audit effort


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California Independent System Operator Corporation

Financial Statements

For the years ended December 31, 2011 and 2010

FERC Form #1 Financial Statements

- Statutory
  - Filed with FERC
  - Available to public through FERC
- Basis of Accounting – FERC Chart of accounts
  - Basic accounting follows normal private accounting principles (FASB)
  - Statutory forms
- Audit comments
  - These are less reader friendly
  - Focus on statutory reporting requirements/ leverage primary audit
  - Net difference - $1.3 million impact to income/loss in 2011

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 (MTM gain of $1.2 million for FERC)
  - Post employment medical plan - different actuarial valuation under FERC ($0.1 million lower expense for FERC)
  - Net loss - $1.3 million lower loss for FERC than corporate
- 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 Assertion
  - Management believes any settlements would likely be resettled against the ISO's markets (not from the ISO)
  - Therefore, no recorded liabilities regarding these market matters
- Disclosures include
  - Refund case stemming from energy crisis
  - Market disputes

Key audit areas

Old headquarters facilities:

- Accounting for estimated future exit costs - $6.4 million
- Loss recorded in 2011 (the substantial cease-use date)

New headquarters building:

- Total capitalized for the new building through 2011 – $130.4 million
- 2011 was the first full year of depreciation on the building
- Building components being depreciated over 20-30 years

Other:

- Determination of fair value for hard to value investments ($1.2 million gain recorded for FERC only)
- Risk of management override of controls – presumed risk (not ISO specific)

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;
    - Rotation for ISO is more strict (5 years) then required
    - Mark Niehaus began partner role this year in accordance with rotation plan
  - Quality review partner role
  - Risk management oversight procedures
  - Each individual verified independence on each engagement

Required communications

There were no:

- Disagreements with Management
- Significant issues discussed prior to retention
- Significant difficulties encountered during the audit
- Material fraud or illegal acts
- Related party transactions, except as disclosed in the notes to the financial statements

Audit adjustments:

- There were no posted audit adjustments
- There were no uncorrected errors

Required communications

Internal controls:

- Scope of audit does not include an opinion on internal controls
- This differs from SSAE 16 audit that we perform over market systems
- During audit we are required to report to the Board of Governors any
  - Material weaknesses
  - Significant deficiencies
- No material weaknesses or significant deficiencies are reported
- Level of audit adjustments is an indicator of potential control issues; there were none
- We have shared controls related observations and recommendations with management in context of continuous improvement

Closing

- We are independent of the ISO and have no relationships with the ISO that would impair our independence
- High level of commitment and cooperation of accounting and other staff greatly appreciated
- PwC encourages communication and feedback from the Board of Governors
- Questions