IESO Management Response

Audit Findings Report for the Year Ended December 31, 2017

The IESO has fully cooperated with the Office of the Auditor General of Ontario (OAGO) with respect to the special audit of the IESO. The IESO recognizes the Auditor General's statutory role and authority to perform an audit of the IESO and has cooperated fully throughout the special audit process.

Over the ten week audit period, IESO staff met with OAGO staff on over 40 occasions and responded to over 200 information requests. The IESO also arranged for working accommodations for seven OAGO staff on IESO premises, complete with access to a private meeting room for their use, as well as direct access to IESO employees. Further, the IESO designated a staff member to assist in coordinating meeting and information requests to ensure it was done in a timely manner. The IESO received positive feedback from OAGO staff on this coordinating role, who noted the helpfulness and convenience of having a single point of contact throughout the audit process.

This spirit of cooperation is one that the IESO has followed in all of its engagements with the OAGO. In addition to the meetings held with IESO staff, the IESO also complied with numerous requests from the OAGO to attend meetings of the IESO's Audit Committee and the full Board of Directors.

Prior to the request from the Auditor General to conduct an attest audit of the IESO's 2017 financial statements, the IESO Board of Directors appointed KPMG as the financial statement auditor, in line with the Board's obligation under s. 25.2 of the *Electricity Act*, 1998. Given that the Board had already retained KPMG to conduct the annual financial statement audit, it is not appropriate for the IESO to sign a management representation letter addressed to the Auditor General, nor can the IESO acknowledge and sign the roles and responsibilities as set out in the Auditor General's proposed engagement letter and audit planning report.

However, in recognition of the OAGO's work, the IESO instructed its auditor, KPMG, to deliver their audit report to the Auditor General and make available their working papers in respect of the OAGO's audit. A copy of the management representation letter provided by the IESO to KPMG will also be shared with the OAGO.

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Powering Tomorrow.

Bank Reconciliations Not Properly Prepared for 2016 and 2017

The IESO prepares timely and appropriate bank reconciliations, and has sufficient internal controls over bank transactions.

The IESO agrees that the noted issue was not appropriately adjusted in a timely manner, but notes that this was an isolated event related to the merger of the former IESO and OPA. The identified issue does not have any impact on the IESO's net surplus or deficit and a repeated event has not occurred.

In the future the IESO commits to preparing timely reconciliations of general ledger accounts and conducting proof of balances throughout each fiscal year, in order to continue to ensure that a repeated event does not occur.

Manual Override of Controls by Human Resources without Proper Approvals

The IESO agrees that there is an opportunity to enhance the internal controls with respect to HR Success Factors.

Due to a system limitation, manual entries for compensation changes may be required in unique instances. Manual entries are only made if supporting evidence is provided. Additionally, compensating controls exist when manual processes are used. Specifically, manual data changes made in the HR Success Factors system are reviewed and approved by the Supervisor, Compensation & Benefits.

Although supporting evidence is provided and compensating controls exist, there is an opportunity to enhance the internal controls. This need was previously identified by the IESO and will be addressed as part of the HR Success Factors system enhancement, scheduled to be implemented in Q3 2018.

Manual Changes Made to Payroll Systems without Proper Approvals

The IESO is in the process of upgrading its payroll system. Automation is a key focus of this project and it is IESO's intent to reduce the need for manual entries. This project is expected to be completed by Q3, 2018.

Any changes to payroll system data are reviewed and signed-off by an employee's supervisor. Specifically, if a payroll change is made by a payroll associate, it is captured in an employee's timesheet that then requires approval by the employee's supervisor.

In addition to timesheet sign-off, the IESO has other compensating controls in place. Specifically, the IESO uses three-way payroll reconciliations to compare payroll data to timesheet data and the payment file from the bank. These reconciliations are prepared by a Financial Analyst and reviewed by the Manager, Accounting and Finance

Security Deposit Not Fully Tracked and Reconciled to General Ledger

The IESO commits to preparing timely reconciliations of general ledger accounts and conducting proof of balances throughout each fiscal year.

Process Descriptions and Control Narratives Not Available

The IESO will continue to review and update its process descriptions and control narratives related to financial reporting, as appropriate. However, the IESO disagrees with the assertion that it lacks process descriptions and control narratives related to financial reporting, and believes the current documents are accurate and effective.

CSAE 3416 Report on Market Settlement Operations System

The IESO will consider this recommendation in future years.

Fair Hydro Plan Transactions and Variance Accounts, Smart Meters and PSAB Transition Item and Market Accounts

The IESO disagrees with the Auditor General's statement that PSAS does not permit rate-regulated accounting. Rather, PSAS is silent with respect to rate-regulated accounting. In absence of a clear position on this issue, standard accounting practice dictates that an entity is entitled to consult another accounting standard. As a result, the IESO consulted US GAAP, the only accounting framework in North America that provides guidance on rate regulated operations.

After extensive discussions with external auditors, the IESO Audit Committee of the Board, as well as the Board of Directors, the IESO adopted aspects of the US GAAP accounting framework allowing the IESO to recognize a regulatory asset on its financial statements. This change brings the IESO in line with (6 of 8) other independent system operators across North America, and is supported by the IESO's external auditors as well as the Office of the Provincial Controller.

In its role as the electricity market administrator, the IESO operates and settles approximately $17 billion through the electricity market transactions, where money is constantly flowing to and from market participants, such as consumers and generators. This role requires the IESO to temporarily hold and transfer money between market participants (like Local Distribution Companies and Generators), including recovering costs associated with Global Adjustment.

The change to include market account assets and liabilities on our financial statements provides increased transparency around the value of transactions that flow through Ontario's electricity market, and the IESO feels the public reporting of market accounts is relevant to the needs of its financial statement users.

These changes in no way affect the IESO's operational costs, or the financial impact on electricity ratepayers.

Value of Plan Assets for IESO Pension Plan

The IESO will consult its actuary to determine appropriateness of adjustment in its December 31, 2018 financial statements.

The IESO has opted to use a market-related value of assets for the purposes of determining pension expense and accrued pension liability, per Section PS 3250, Paragraph 35. If IESO disclosed the funded status of the pension plan using the market-related value of assets rather than the market value of assets, there would be no impact on either the pension expense or the accrued pension asset and liability.

Discount Rate Selected for Non-Registered Defined Benefit Plan and Other Post-Employment Benefits

The IESO is aware that the Public Sector Accounting Board recently issued an invitation to comment on how the discount rate under PSAB is determined. When changes are made, the IESO will review and consider adopting a new discount rate methodology, if appropriate.

Section PS 3250 does not recommend a specific methodology for determining the discount rates to measure the liability of benefit programs; however, two examples are identified in the standard as reference points for determining an acceptable discount rate. The two examples include the expected return on plan assets and the organization's cost of borrowing. Further, the IESO believes that an inconsistency in valuation of overall pension benefit would be created if different discount rates were used for the registered pension plan and the other plans.

Given this, the IESO believes that its discount rate assumptions for the other plans are within the bounds of reasonableness and will maintain the current discount rates for the pension and OPEB plans in its 2017 financial statements. More specifically the discount rate on the registered pension plan is determined with reference to the expected return on plan assets and the discount rates assumptions for the other plans are determined with reference to the discount rate on the registered pension plan.