



CHELAN COUNTY

AUDIT COMMITTEE

2018 Annual Report
February 19, 2019

Introduction

The Audit Committee Charter calls for annual reporting to the Board of Commissioners and General Manager about activities, issues and related recommendations. The Audit Committee was created by Resolution No. 04-12597 as a governance best practice and to provide functional reporting independence for Internal Audit. The Committee consists of the President and Vice President of the Board of Commissioners with the Secretary serving as alternate, as well as the District's General Counsel, Senior Manager for Customer Utilities, Generation & Transmission, District Services and the Chief Financial/Risk Officer.

Meetings Summary

March 2018-First Quarter Meeting

The State Auditor's Office (SAO) was in attendance to share the results of the Energy Independence Act renewable energy compliance examination for 2016. The District complied, in all material respects, with the renewable energy requirements of the Act.

PricewaterhouseCoopers (PwC) presented the results of the 2017 financial statement audit. An unqualified (clean) opinion for the audit was issued on April 20, 2018. No material weaknesses or significant deficiencies were noted in internal controls. Areas of focus included:

- Management override of controls - No instances of management manipulation or fraud were found.
- Revenue recognition limited to "non-regulated" market-based sales – No material misstatements were noted.
- Accounting for firm revenue contracts (Alcoa specific)-Confirmed the amount of revenue for the year utilized by Alcoa. Confirmed revenue sold on the open market on behalf of Alcoa, directly with each individual third party. Testing over the revenue surplus was performed, without exception.
- Capitalization of costs in utility plant – Determined all selected items were recorded appropriately.
- Accounting for power contracts and derivatives – PwC recalculated the fair value of the District's forward purchase derivative instruments without exception.
- Regulatory accounting – Confirmed all current deferrals were appropriate and recalculated the current year amortization of regulatory balances without exception.

PwC concluded that there were no material uncertainties related to events and conditions, specifically going concern issues. Management disclosed all significant risks. No instances of fraud or illegal acts were found during the course of the audit.

Enterprise Risk Management (ERM) provided the Committee with a quarterly update on key risks and new and modified items in the risk register. ERM reported on a plan to conduct an enterprise-wide Business Continuity mock test that includes evacuating all employees from headquarters.

Internal Audit updated the Committee on the 2018 audit plan status. Pcard and expense report reviews for 2017 are complete and results were presented to the Committee. 83% of total expense reports dollars, and 31% of Pcard dollars were reviewed. No major concerns were found.

Internal Audit will undergo their first external quality assessment review in accordance with the International Standards for the Professional Practice of Internal Auditing in November 2018.

General Counsel reported on the annual Disclosure Committee Questionnaire. The Senior Management Team reviewed and discussed the results and no immediate threats were identified.

June 2018-Second Quarter Meeting

The External Financial Reporting Program Manager updated the committee on GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits other than Pensions (OPEB), effective for the District's 2018 financial statements. District retirees (under the age of 65) have the option to purchase health insurance through the District's self-insured plan at a subsidized rate. Providing this benefit to retirees is considered other postemployment benefits and is required to be accounted for under the new accounting guidance. The 2018 changes will not have a material impact on the District's income statement or balance sheet.

Internal Audit provided an update on the follow-up to the Fuel review. Recommendations were resolved or in the process of being resolved. No further follow up is required. Status of the 2018 audit plan was provided. Internal Audit reported on the Audit Committee Self Assessment Survey Results. The assessment is currently being performed every two years.

ERM updated the Committee on key risks, items added to the risk register and future efforts. ERM also reported on the decision to postpone the business continuity headquarters evacuation test until 2019. ERM is continuing to work on prerequisite steps that need to be accomplished prior to the test.

The Compliance Manager reported on the upcoming WECC Reliability Audit which takes place every three years. The next audit for the District will be performed between April 29 and May 10, 2019.

September 2018-Third Quarter Meeting

PwC provided an overview of the upcoming 2018 audit plan. Areas of emphasis include management override of controls, fraud in non-firm wholesale revenue recognition, capital versus expense classification, accounting for power contracts and other derivatives, regulatory assets, accruals and long-term debt, and Alcoa. Year-end fieldwork will be performed from February 25 to March 15, 2019 with an anticipated report date in mid-April.

The Internal Audit Manager updated the Committee on the Washington State Department of Labor & Industries Timeliness Audit Report. The audit was conducted to evaluate the timeliness of time-loss compensation payments. The District's timeliness of transactions passed L&I's threshold for this audit. No late transactions were identified. The results of the completed Fleet Replacement and Purchasing audit were shared.

A summary of the Internal Audit Self-Assessment, as part of the Internal Audit Quality Assurance Improvement Plan (QAIP), was provided. The QAIP is designed to provide reasonable assurance that the Internal Audit activity complies with professional auditing standards and codes of ethics; is monitored to ensure effective and efficient operations; adds value and improves organizational operations; includes periodic and ongoing internal assessments and includes an external assessment at least once every five years.

Internal audit presented for approval updates to their charter. It was moved and seconded to adopt the charter as revised in April 2018.

The Senior Accounting Analyst addressed the Committee on accounting for transformers and electric meters. The District currently applies the FERC guidance, meaning that transformers and meters are capitalized at the time of purchase. There is a utility industry trend to move toward following traditional GAAP for capitalization of transformers and meters. The District is reviewing several options.

ERM updated the Committee on tier 1 key risks, and other risk register changes. It was also reported that the Risk Appetite Statement was updated for 2018 and approved by the Risk Committee.

November 2018-Special Meeting

The SAO was in attendance to share the results of the 2017 Accountability audit. The following areas were reviewed:

- Decentralized cash receipting for Leavenworth, Chelan and Beebe Park
- Utility billing and adjustments
- Credit card purchases
- Payroll (overtime calculation and support for pay increases)
- Financial condition-debt service
- Procurement-public works projects, general purchases and sole source purchases

The District complied with applicable federal and state laws, regulations, policies and procedures and provided adequate safeguarding of public resources. No recommendations were received. The report will be released within the next two weeks.

January 2019-Fourth Quarter Meeting

The SAO reported on the compliance examination of the Energy Independence Act ("Act"). The District complied with its 15,592 MWh energy conservation target in accordance with the Act's requirements. The target compliance period was January 1, 2016 through December 31, 2017. The examination disclosed no issues that are required to be reported under *Government Auditing Standards*.

The District also complied with its renewable energy target in accordance with the Act's requirements. The target compliance period was January 1, 2017 through December 31, 2017. The District's renewable energy target of 140,546 MWh was fairly stated and represents nine percent (9%) of its 1,561,621 MWh average retail load in accordance with the Act. In the opinion of the SAO, the District complied, in all material respects, with the renewable energy requirements of the Act.

The External Financial Reporting Manager reported on the PricewaterhouseCoopers ("PwC") 2018 financial statement audit. PwC will be onsite starting February 25, 2019. District staff is currently working on preparing the 2018 financial statements, footnote disclosures and 157 requested audit schedules.

Next an update was provided to the Committee on significant year-end accounting items as follows:

- Annual Adjustment of Pension Amounts

- Implementation of GASB 74 – Postemployment Benefits other than Pension (OPEB)
- Early Adoption of GASB 89 – Accounting for Interest Costs incurred before the End of a Construction Period
- Hydropower Research Institute (HRI)

Internal Audit presented Executive Summaries of the 2018 Contracts Review follow-up, the 2018 Pole Attachments check-in and the Alternative Bid/Quote Process follow-up. They also presented the Internal Audit Reports from September 2004 to December 2018.

Internal Audit discussed the 2018 Internal Audit Activity Annual Report. The 2018 goal for time spent on direct audit hours was set at 75%. Actual productivity for 2018 was 76% as compared to 74% in 2017. The completion goal is 80% of high priority audits. In 2018, 100% of Internal Audit’s high priority audits were completed.

Internal Audit provided the draft 2019 Audit Plan. After interviews with District personnel on what should be included in the Audit Plan, a 2019 planning matrix was compiled, that demonstrates the potential impact of resource limitations by showing all risk areas considered for review by Internal Audit, management or excluded from the plan. After discussion, the 2019 plan was approved.

Internal Audit reported on the 2018 external quality assessment results. The overall opinion from the assessment is that Internal Audit generally conforms with the *International Standards for the Professional Practice of Internal Auditing* (“Standards”) and the IIA Code of Ethics. “Generally conforms” is the top rating and means the assessment team concluded that relevant structures, policies and procedures of the activity, as well as the processes by which they are applied, comply with the requirements in all material respects. The objectives of the audit were to assess conformance with the *Standards* and the IIA Code of Ethics; assess the effectiveness in providing assurance and advisory services to the Audit Committee, senior stakeholders and other interested parties; and identify opportunities, offer recommendations for improvement, and provide counsel to Internal Audit for improving their performance and services and promoting their image and credibility. The assessment results noted that the Internal Audit Manual that documents the underlying policies, procedures and infrastructure is well done – especially for a smaller audit activity. The work papers for individual audit engagements were documented in a complete and high quality manner and an effective monitoring process is in place to ensure observations are addressed by management. Gaps to conformance with the *Standards* were (1) conduct an external quality assessment at least every five years and (2) communicate the results in a manner consistent with the requirements. Upon communication of the assessment, Internal Audit will be in full conformance with the *Standard*. Opportunities for continuous improvement were also included in the assessment.

ERM reported on two 2018 Q3 tier 1 key risks that ERM suggests moving to tier 2. No new tier 1 key risks have been identified.