



CHELAN COUNTY

# AUDIT COMMITTEE

2019 Annual Report  
February 18, 2020

## 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 2019-First Quarter Meeting

The Controller reported on the District's evaluation of PricewaterhouseCoopers (PwC) performance as the independent auditor of the District's financial statements and their current contract, which expires in August 2019. It is the Audit Committee's responsibility to review the external auditor's proposed audit scope and approach, and fees and performance. PwC was evaluated against specific criteria and staff input on performance was considered. The overall conclusion is that the District is satisfied with PwC's performance. The Audit Committee authorized an extension with PwC to continue to perform the District's audit services.

Enterprise Risk Management (ERM) provided the Committee with a quarterly update on key risks and new and modified items in the risk register. ERM also reported on the District's liquidity reserves.

Internal Audit updated the Committee on the 2019 audit plan status. Pcard and expense report reviews for 2018 are complete and results were presented to the Committee. Process changes that occurred in 2018 included changing the Pcard reviews from monthly to quarterly and increasing the threshold for Accounts Payable review of Expense Reports from \$300 to \$750. 70% of total expense reports dollars, and 16% of Pcard dollars were reviewed. The change to quarterly reviews performed by Internal Audit supports a shift of hours to audit work.

The Compliance Manager reported on the upcoming WECC audit. The 2019 audit scope for WECC includes 24 requirements. The District also elected to participate in an Internal Controls Evaluation ("ICE") which is a voluntary process used to evaluate the design and effectiveness of the District's internal control program. The ICE interviews and data requests have been completed. WECC will be on site on May 6-9. It is estimated that the final audit report will be received June month end.

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

### April 2019-Special Meeting

PwC presented the results of the 2018 financial statement audit. An unqualified (clean) opinion for the audit is expected to be issued on April 19, 2019. 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.
- Fraud in Revenue recognition (non-firm wholesale revenue) – No significant issues or exceptions were noted.
- Alcoa - Confirmed the amount billed directly with Alcoa. Confirmed a sample of surplus power transactions, without exception.
- Capitalization vs. expense classification – Sampled both expenses and capitalized costs to validate appropriate classification, and determined all selected items were recorded appropriately.
- Accounting for power contracts and derivatives – Confirmed revenue per contract terms with large customers, and recalculated the fair value of any derivative instruments without exception.
- Regulatory assets – Tested new deferrals and accruals in the year and recalculated amortization in the period.
- Accruals and long-term debt - Analyzed significant accruals at year end and confirmed long-term debt balances directly with financial institutions.

PwC also looked at the District's adoption of GASB Statement No. 75 (Accounting and Financial Reporting for Postemployment Benefits other than Pensions) and noted no significant exceptions or issues.

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.

## June 2019-Second Quarter Meeting

Internal Audit provided a brief update on the follow-up efforts for the Fleet Replacement and Purchasing audit. Status of the 2019 audit plan was provided. Internal Audit reviewed with the Committee proposed changes to the Internal Audit Charter. Language is being added to include other professional guidance as defined by the International Professional Practices Framework (IPPF) including implementation guidelines issued for each standard and supplemental guidance that includes all Practice Guides, Global Technology Audit Guides and guides to the Assessment of IT Risks.

Internal Audit and ERM reported to the Committee on the Energy Resources Fraud Risk Assessment and the risk/control matrix. ERM and Internal Audit collaborated with Energy Resources to brainstorm trading fraud risk scenarios and document controls and monitoring practices currently in place.

ERM updated the Committee on key risks, and items added to the risk register.

The Controller next discussed the Memorandum of Agreement (MOA) which was presented by the State Auditor's Office (SAO) in 2017 to allow the District to separately contract with a CPA firm to perform its financial audit, instead of using the SAO. The District, along with other PUDs who contract with CPA firms, provided suggested edits to the SAO and did not sign the MOA at that time. Recently Benton County PUD received a letter from the SAO regarding use of a CPA firm audit in lieu of an SAO audit. The District will continue to monitor the situation.

## September 2019-Third Quarter Meeting

Internal Audit and Energy Trading recapped a 2017 Environmental Attribute Internal Audit. The purpose of this audit was to determine the adequacy and effectiveness of internal controls over the tracking and accounting of environmental attributes, address risks identified by management and ensure environmental attribute sales are supported and properly accounted for as a single type of sale. The audit results showed the adequacy and effectiveness of the risk management and control process is strong, procedures are adequate and functioning correctly, reported sales were supported and properly accounted for as a single type of sale, and provided staff with documented processes and controls. The District retained a consultant to review the District's approach to environmental accounting, validate the 2017 internal audit and address risks of double-counting and resource shuffling. This review showed the internal audit was consistent with accepted auditing standards, environmental attributes were tracked and accounted for properly, concurring with the 2017 internal audit, there is a "very low probability of accounting errors," and the District is in compliance and has "adequately and professionally addressed any concerns associated with double-counting and resource shuffling."

Internal Audit provided status of the 2019 audit plan and discussed the recent Business Systems IT Governance review. Reviews of Rock Island Powerhouse 1 Rehab Quality and Inspection Program, Generation Energy Isolation Program, and the Hydropower Research Institute are in progress.

ERM's Middle Office provided an update on Energy Transactions Internal Controls. The purpose of this presentation was to provide a broad overview of the internal control structure in place throughout the transaction lifecycle, including governance, segregation of duties and responding to an action item to review whether additional controls are necessary to detect transactions executed out of market range. Specific topics included an overview of the roles and oversight responsibilities of the Power Risk Management Committee, the Power Risk Management Policy that governs energy transacting and defines strategy, Front-Middle-Back office structure and roles and responsibilities, the internal controls throughout the life-cycle of a trade and other control responsibilities independent of those executing the trades.

ERM updated the Committee on tier 1 key risks, and other risk register changes. It was also reported the high-level results of the 2019 ERM Maturity Model survey were slightly below the maturity score target.

Internal Audit and Compliance reported that the State's Accountability Audit went well and the SAO completed fieldwork in September.

## November 2019-Special Meeting

The SAO was in attendance to share the results of the 2018 Accountability Audit. The following areas were reviewed:

- Self-Insurance for property, health and welfare, unemployment and workers compensation
- Accounts Payable – General Disbursements
- Tracking and monitoring of theft-sensitive assets
  - Tool Rooms
- Payroll
  - Gross wages
  - Direct Deposits

- Benefit Deductions
- IT Security
  - Data Backup and Recovery
  - User Access
- Procurement
  - Vendor List
  - Small Works
  - General Contractor/Construction Management

The District complied with applicable federal and state laws, regulations, policies and procedures and provided adequate safeguarding of public resources.

PwC provided an overview of the upcoming 2019 financial audit plan. Primary objectives include performing the audit in accordance with auditing standards generally accepted in the United States, render an opinion of the financial statements as of December 31, 2019. Areas of emphasis for the 2019 audit will include capital vs. expense classification, accounting for power contracts and other derivatives, accruals and long-term debt, fiduciary activities, regulatory assets, the Alcoa contract, the Microsoft contract, and asset retirement obligations. Field work will be performed in February and March 2020 with an anticipated report date in April.

### January 2020-Fourth Quarter Meeting

The SAO reported on the compliance examination of the Energy Independence Act (“Act”). The District complied with its renewable energy target in accordance with the Act’s requirements. The target compliance period was January 1, 2018 through December 31, 2018. The District’s renewable energy target of 149,229 MWh was fairly stated and represents nine percent (9%) of its 1,658,102 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 examination disclosed no issues that are required to be reported under *Government Auditing Standards*

The External Financial Reporting Program Manager reported on the PwC 2019 financial statement audit. PwC will be on-site for fieldwork from March 2 through March 20. District staff is currently working on preparing the 2019 financial statements, footnote disclosures and 152 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 83 – Certain Asset Retirement Obligations
- Implementation of GASB 84 – Fiduciary Activities

The External Financial Reporting Program Manager also reported that a resolution to *Request Board Approval of Regulatory Accounting* will be brought to the Board of Commissioners at the February 3, 2020 Board meeting. Implementation of Regulatory Accounting gives the District assurance that it will be able to align the financial statement impacts of a transaction with the recovery of costs through rates over future periods.

Internal Audit presented Executive Summaries of the 2019 Rock Island Powerhouse 1 Rehab-Quality and Inspection Program, the Generation Energy Isolation Program and the Hydropower

Research Institute. They also provided, for information, a listing of Internal Audit Reports from September 2004 to December 2019.

Internal Audit discussed the 2019 Internal Audit Activity Annual Report. The 2019 goal for time spent on direct audit hours was set at 75%. Actual productivity for 2019 was 77% as compared to 76% in 2018. The completion goal is 80% of high priority audits. In 2019, 83% of Internal Audit's high priority audits were completed. The report also includes a status on improvement opportunities implemented, allocation of direct audit hours, department budget and audit customer survey responses.

Internal Audit provided the draft 2020 Audit Plan. After interviews with District personnel on what should be included in the Audit Plan, a 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 2020 plan was approved.

ERM reported on 2019 Q4 tier 1 key risks that ERM suggests moving to tier 2. No new tier 1 key risks have been identified.