



CHELAN COUNTY

AUDIT COMMITTEE

2017 Annual Report
February 20, 2018

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 2017-First Quarter Meeting

The District's Controller provided an update on the 2016 PricewaterhouseCoopers (PwC) financial audit. Fieldwork is complete and no significant unresolved issues or control weaknesses were identified. The audit report is anticipated in mid-April.

Enterprise Risk Management (ERM) provided the Committee with a quarterly update on key risks and new and modified items in the risk register.

Internal Audit updated the Committee on the 2017 Audit Plan status. Pcard and expense report reviews for 2016 are complete and results were presented to the Committee. Internal Audit reported on the fuel review in progress.

The Director of Security presented the Physical Security Program "Upgrades and Enhancements" to the Committee. The goals are to enhance the District's Physical Security Program for high value assets (critical infrastructure); elevate the FERC Security Program with increased security measures; and exceed NERC CIP compliance for all District low, medium and high impact sites. Projects identified include the District's closed circuit TV (CCTV) system replacement from unsupported analog to digital HD network; increased monitoring of cyber assets and controlling physical access to cyber assets to meet the new NERC CIP-003 requirements by July 1, 2018; and an upgrade, expansion and unification of corporation and CIP access control platforms (adding new access control points, use of Smart card technology and specially designed physical security zones).

May 2017-Special Meeting

PwC presented the results of the 2016 financial statement audit. An unqualified (clean) opinion for the audit has been issued. No material weaknesses or significant deficiencies were noted in internal controls. Areas of focus included (1) management override of controls - no instances of management manipulation or fraud were found; (2) revenue recognition limited to "non-regulated" market-based sales – no material misstatements were noted; (3) capitalization of costs in utility plant – determined all items were recorded appropriately; (4) accounting for power contracts and derivatives – PwC recalculated the fair value of the District's forward purchase derivative instruments without exception; (5) regulatory accounting – confirmed all current deferrals were appropriate and recalculated the current year amortization of regulatory balances without

exception; (6) GASB 72 Adoption – PwC audited the fair value measurement of the District’s investment portfolio in addition to testing the fair value hierarchy assignment of the PUD’s investment assets; (7) FEMA grant – no finding of noncompliance. 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 2017-Second Quarter Meeting

Internal Audit reported the 2016 State Auditor’s annual accountability audit and single audit are underway. The single audit is a review of grant funding received by the District.

The Controller reported on the State Auditor’s Office (SAO) policy changes. Starting in fiscal year 2018, the SAO will require all financial audits to be performed under Generally Accepted Government Auditing Standards (GAGAS). They will still allow independent auditors to perform the financial audits but under new conditions. The SAO is directing the District to sign a Memorandum of Agreement (“MOA”) for fiscal years 2018-2020, which formalizes the District’s use of an independent accounting firm. District staff believes that the MOA may result in duplication of effort and added costs without additional value. The District is currently working with other PUDs to propose a PUD MOA template for the SAO’s consideration.

The External Financial Reporting Program Manager reported to the Committee on new accounting pronouncements. There were five new GASB statements effective in 2017 that have no or minimal impact to the District. Three statements that go into effect in 2018 and 2019 have moderate to significant impacts to the District:

- GASB No. 75 establishes new accounting and financial report requirements for governments whose employees are provided OPEB (retiree medical).
- GASB No. 84 establishes criteria for identifying fiduciary activities of all state and local governments.
- GASB No. 86 establishes standards of accounting and financial reporting for in-substance defeasance transactions in which cash and other monetary assets are placed in an irrevocable trust for the purpose of debt extinguishment.

Internal Audit and the Director of Shared Services reported on the Contracts audit. The following areas of risk were identified for review: (1) contract award and signature authority; (2) contract monitoring and spending limits established by resolution; and (3) field work orders/change orders and service agreement amendments. Opportunities for improvement were provided to management. Internal Audit reported on the Fuel Review in which they were notified by the Supply Chain and Fleet Manager of an anomaly in odometer reads while reviewing error reports from the District’s fueling system. The SAO was notified in accordance with policy and State law. Internal Audit determined the fueling anomaly identified by Fleet was likely the result of a data entry error. Internal Audit provided updates on the Tool Room and Alternative Bid/Quote Process follow-up audits resulting from recommendations by the SAO.

ERM updated the Committee on key risks, items added to the risk register and future efforts. The 2017 ERM maturity model survey is complete and reports were sent to the Managing Directors.

General Counsel reported on the annual Disclosure Committee Questionnaire. No items were reported that the Disclosure Committee was unaware of.

September 2017-Third Quarter Meeting

The SAO was in attendance to share the results of the following audits.

- Energy Independence Act renewable energy compliance examination for 2015
- Energy Independence Act energy conservation compliance examination for 2014-2015
- Federal grant compliance audit for 2015
- Accountability audit for 2016
 - Self-insurance processes
 - Line extension and connection fees
 - Employee personal leave balances and transactions
 - Competitive bidding requirements and
 - Employee travel and expense reimbursements
- Review of the District's Internal Audit fuel use review for February 2016 through February 2017

For all of the above examinations performed by the SAO, the District complied with applicable federal and state laws, regulations, policies and procedures and provided adequate safeguarding of public resources. The SAO discussed two Statewide PUD updates:

- In-House Labor Limits-RCW 54.04.070, the Washington PUD Association is looking at potential changes to the RCW.
- Memorandum of Agreement-regarding financial statement audits performed by CPA firms. The SAO shared the first version of the MOA in fall 2016. The District's Controller is coordinating with other utilities to gather/combine feedback for the SAO on the current draft.

Internal Audit reported on historical State Audit Focus Areas. A matrix was developed which shows areas that the SAO focused on for all utilities in the state and also where the District audits stack up against the other public utility districts. This information is used to help prepare for the annual SAO audit. Internal Audit proposed the District budget for an external assessment in 2018 as part of an Internal Audit Quality Assurance program as outlined in audit standards. An update of the 2017 audit work plan currently includes a review of environmental attributes and a follow-up of Skaha Hatchery Construction close-out as in progress.

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

November 2017-Special Meeting

PwC provided an overview of the upcoming 2017 audit plan. An area of emphasis includes Alcoa's operational shutdown at Wenatchee Works and the impact to the PUD's power sales contract (as amended). They will also concentrate on significant risks including management override of controls and revenue recognition for non-regulated/market-based sales. Other areas of audit emphasis include capital versus expense classification, accounting for power contracts and other derivatives, regulatory assets, and accruals and long-term debt. Year-end fieldwork will be performed from February 26 to March 16, 2018 with an anticipated report date in mid-April.

January 2018-Fourth Quarter Meeting

The External Financial Reporting Program Manager updated the Committee on significant year-end accounting items such as pension accounting and medical/dental claims liability. The External Financial Reporting Program Manager also reported on the PwC 2017 financial statement audit. PwC will be on site starting February 26 through March 16, 2018.

Internal Audit presented several Executive Summaries: follow-ups to Pole Attachments, Contracts, Skaha Hatchery Construction Closeout, Safety Department-Incident Analysis and a review of Environmental Attributes. Internal audit provided the Committee with a summary of Internal Audit reports from September 2004 through December 2017. Internal Audit discussed the Pcard Review and Reporting Process and proposed changes. Status of where Internal Audit ended the year with their 2017 work plan was reviewed. The 2018 Internal Audit work plan was reviewed and approved by the committee.

The ERM Senior Business Analyst presented an update on key and reclassified risks and reported on the 2018 Business Continuity Test. The District's performance plan calls for conducting an enterprise-wide mock test. ERM will plan and facilitate the test.

The Compliance Program Manager gave an update on the Governance, Risk and Compliance (GRC) Implementation. The GRC implementation group met with the software provider, and the implementation and configuration contractor to kick off the project. The District will be using a Quick Start implementation methodology that is designed to get the various modules up and running with samples of District processes for testing.