



# Utility Debt Securitization Authority

## Report to the Finance and Audit Committee

**Audit plan and strategy for the year ending December 31, 2018**

December 12, 2018

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# Introduction

## To the Finance and Audit Committee of the Utility Debt Securitization Authority

We are pleased to have the opportunity to meet with you on December 12, 2018 to discuss our audit of the basic financial statements of the Utility Debt Securitization Authority (the Authority) as of and for the year ending December 31, 2018.

The audit of the basic financial statements, prepared in accordance with U.S. generally accepted accounting principles (GAAP), will be conducted under the standards of U.S. generally accepted auditing standards (GAAS) and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

We plan to issue the auditors' report on the basic financial statements of the Utility Debt Securitization Authority, as of and for the two-year period ended December 31, 2018.

Other planned audit deliverables include:

- Report on Internal Control Over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Accounting Standards as of December 31, 2018
- Report on Investment Compliance as of December 31, 2018;
- Restructuring Property Servicing Agreements Agreed Upon Procedures Report as of December 31, 2018
  - Series 2013 Bonds
  - Series 2015 Bonds
  - Series 2016A Bonds
  - Series 2016B Bonds
  - Series 2017 Bonds

This document, which outlines our risk assessment and planned audit strategy, is being provided to you in advance of the meeting to allow you sufficient time to consider the key matters and formulate your questions.

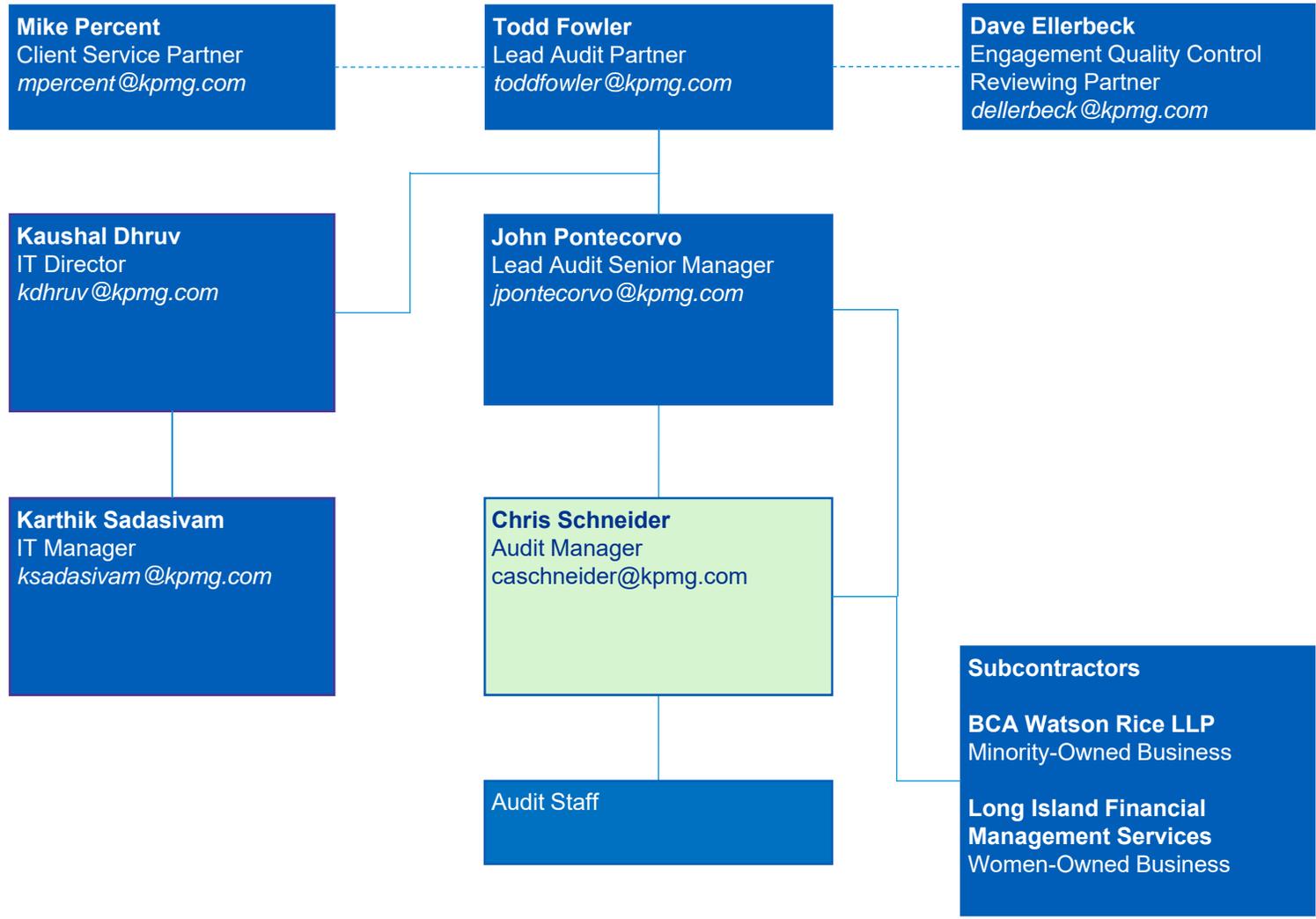
We believe the contents of this document should provide a good platform for our discussions when we do meet. We will be pleased to elaborate further on matters covered in this document at the meeting.

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# Client service team



*Team members with continuity are designated in blue.*



# Risk assessment

Relevant factors affecting our risk assessment:

Significant risks	Susceptibility to		Recent significant developments	Complexity	Related Parties	Degree of subjectivity	Outside normal course of business
	Error	Fraud					
Risk of management override of controls – Management is in a unique position to perpetrate fraud because of management’s ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk nevertheless is present in all entities.							

 Yes  No



# Risk assessment (continued)

Relevant factors affecting our risk assessment:

Other Significant Audit Matters	Susceptibility to		Recent significant developments	Complexity	Related parties	Degree of subjectivity	Outside normal course of business
	Error	Fraud					
<b>Significant Audit Areas:</b>							
Revenue Recognition	✓	●	●	●	●	●	●
Long term debt	✓	●	●	●	●	●	●
Restructuring property	✓	●	●	●	●	●	●
Unbilled Revenue	✓	●	●	●	●	●	●

 Yes
  No



# Audit strategy

## Involvement of others

Audit of basic financial statements	Plan to involve?	Extent of planned involvement
Internal Audit	Y	Inquiries of Internal Audit, Review Internal Audit Plan, and Review results of Internal Audits performed
KPMG Specialists	N	

 Yes  No

# Planned timeline

- Debrief on audit process
- Plan audit approach for upcoming year-end audit
- Identify key members of the engagement team, including specialists

- Meetings with management to discuss key issues
- Assessment of business processes and high-level controls
- Identify specific and pervasive financial statement fraud risks and assess the effect on the audit plan
- Perform risk assessment procedures and identify risks
- Assessment of audit risk and planning of substantive audit procedures
- Determine audit strategy and identify critical accounting matters
- Plan Audit Procedures

3-31-2019

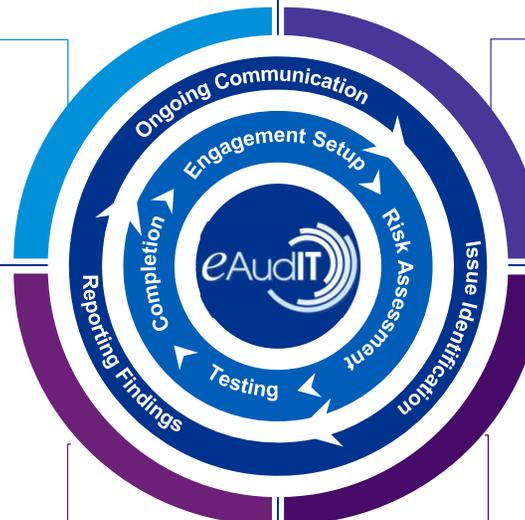
- Meetings with management to discuss key issues
- Test operating effectiveness of selected year-end controls at UDSA and PSEG-LI
- Perform substantive audit procedures and tests of detail
- Consider if audit evidence is sufficient and appropriate
- Conclude on critical accounting matters and issues
- Confirm completion procedures
- Form audit conclusions
- Review financial statement disclosures
- Evaluate results of audit procedures including control deficiencies and audit misstatements identified
- Obtain written representation from management
- Present audit results to the Finance and Audit Committee and perform required communications
- Issue audit reports on basic financial statements

9-30-2018

- Finalize planned audit approach
- Present 2018 Audit Plan to the Finance and Audit Committee
- Perform walkthroughs of UDSA and PSEG-LI processes
- Evaluate design of selected key controls at UDSA and PSEG-LI
- Test operating effectiveness of selected key controls at UDSA and PSEG-LI
- Perform interim substantive procedures
- Evaluation of interim results and establish plan for performance of substantive audit procedures
- Perform / send year-end confirmations (e.g. legal, debt, and cash)
- Conduct management interviews related to fraud risk

6-30-2018

12-31-2018





# Supplemental communications

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# Audit fees

	2018 estimated	2017 actual
Audit of the basic financial statements for the Utility Debt Securitization Authority as of and for the two-year period December 31, 2018	\$75,000	\$75,000
Other Reports (including in the fees above):		
Report on Internal Control Over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Accounting Standards as of December 31, 2018		
Report on Investment Compliance as of December 31, 2018		
<b>Total fees</b>	<b>\$75,000</b>	<b>\$75,000</b>

The following reports will be billed separately (\$15,000 per report):

- Restructuring Property Servicing Agreements Agreed Upon Procedures as of December 31, 2018 (5)
  - Series 2013 Bonds
  - Series 2015 Bonds
  - Series 2016A Bonds
  - Series 2016B Bonds
  - Series 2017 Bonds



## Materiality

# Materiality in the context of an audit

**We will apply materiality in the context of the preparation and fair presentation of the financial statements, considering the following factors:**

Professional standards require that we exercise professional judgment when we consider materiality and its relationship with audit risk when determining the nature, timing, and extent of our audit procedures, and when evaluating the effect of misstatements.

Information is material if its misstatement or omission could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.

Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Judgments about the size of misstatements that will be considered material provide a basis for

- a) Determining the nature and extent of risk assessment procedures;
- b) Identifying and assessing the risks of material misstatement; and
- c) Determining the nature, timing, and extent of further audit procedures.

Required communications and other matters

# Responsibilities

<p><b>Management responsibilities – Basic Financial statements</b></p>	<ul style="list-style-type: none"> <li>— Fairly presenting the financial statements, including disclosures in conformity with U.S. GAAP</li> <li>— Adjusting the financial statements to correct material misstatements and affirming in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor are immaterial, both individually and in the aggregate, to the financial statements taken as a whole</li> </ul>
<p><b>Management responsibilities – Internal control over financial reporting (ICOFR)</b></p>	<ul style="list-style-type: none"> <li>— Design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error</li> </ul>
<p><b>Management responsibilities – Other</b></p>	<ul style="list-style-type: none"> <li>— To provide the auditor with:                             <ul style="list-style-type: none"> <li>(1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;</li> <li>(2) additional information that the auditor may request from management for the purpose of the audit; and</li> <li>(3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence</li> </ul> </li> <li>— Identifying and ensuring that the UDSA complies with laws and regulations applicable to its activities, and for informing the auditor of any known material violations of such laws and regulations</li> <li>— Providing the auditor with a letter confirming certain representations made during the audit, that includes but is not limited to management’s:                             <ul style="list-style-type: none"> <li>(1) disclosure of all significant deficiencies, including material weaknesses, in the design or operation of internal controls that could adversely affect the UDSA’s financial reporting</li> <li>(2) acknowledgement of their responsibility for the design and implementation, and maintenance of internal controls to prevent and detect fraud</li> </ul> </li> </ul>
<p><b>Finance and Audit Committee responsibilities</b></p>	<ul style="list-style-type: none"> <li>— Oversight of the financial reporting process and ICOFR</li> <li>— Oversight of the establishment and maintenance by management of programs and controls designed to prevent, deter, and detect fraud</li> </ul>
<p><b>Management and the Finance and Audit Committee responsibilities</b></p>	<ul style="list-style-type: none"> <li>— Setting the proper tone and creating and maintaining a culture of honesty and high ethical standards</li> <li>— Ensuring that the UDSA’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in the UDSA’s financial statements.</li> </ul>

The audit does not relieve management or the Finance and Audit Committee of their responsibilities.



Required communications and other matters

# Responsibilities (continued)

<p><b>KPMG – Audit objectives</b></p>	<ul style="list-style-type: none"> <li>— The objective of an audit of the basic financial statements is to enable the auditor to express an opinion about whether the basic financial statements that have been prepared by management with the oversight of the Finance and Audit Committee are presented fairly, in all material respects, in conformity with generally accepted accounting principles (GAAP), including Government Accounting Standards, as issued by the Government Accounting Standards Board (GASB).</li> <li>— We plan and perform the audit to obtain reasonable, rather than absolute, assurance about whether the basic financial statements taken as a whole are free from material misstatement, whether due to fraud or error.</li> <li>— Our audit includes:             <ul style="list-style-type: none"> <li>Performing tests of the accounting records and such other procedures, as we consider necessary in the circumstances, based on our judgment, including the assessment of the risks of material misstatement, to provide a reasonable basis for our opinion.</li> <li>Evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, and evaluating the overall presentation of the basic financial statements.</li> </ul> </li> </ul>
<p><b>KPMG responsibilities – Audit</b></p>	<ul style="list-style-type: none"> <li>— Forming and expressing an opinion about whether the basic financial statements that have been prepared by management, with the oversight of the Finance and Audit Committee, are presented fairly, in all material respects, in conformity with GAAP.</li> <li>— Planning and performing our audit with an attitude of professional skepticism to obtain reasonable—not absolute—assurance about whether the basic financial statements are free of material misstatement, whether caused by fraud or error. Because of the nature of audit evidence and the characteristics of fraud, we are able to obtain reasonable, but not absolute, assurance that material misstatements will be detected. Our audit is not designed to detect error or fraud that is immaterial to the basic financial statements.</li> <li>— Conducting the audit in accordance with professional standards and complying with the Code of Professional Conduct of the American Institute of Certified Public Accountants, and the ethical standards of relevant CPA societies and relevant state boards of accountancy.</li> <li>— Evaluating ICOFR as a basis for designing audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the UDSA’s ICOFR.</li> <li>— Communicating to management and the Finance and Audit Committee all required information, including significant matters.</li> <li>— Communicating to management and the Finance and Audit Committee in writing all significant deficiencies and material weaknesses in internal control identified during the audit and reporting to management all deficiencies noted during our audit that are of sufficient importance to merit management’s attention. The objective of our audit of the basic financial statements is not to report on the UDSA’s internal control and we are not obligated to search for material weaknesses or significant deficiencies as part of our audit of the basic financial statements.</li> </ul>



## Required communications and other matters

# Responsibilities (continued)

<b>KPMG responsibilities – Other information in documents containing basic financial statements</b>	<ul style="list-style-type: none"><li>— The auditors' report on the USDA's financial statements does not extend to other information in documents containing the audited basic financial statements, excluding required supplementary information.</li><li>— We are required to:<ul style="list-style-type: none"><li>-Read the other information to identify material inconsistencies with the audited basic financial statements or material misstatements of fact, and</li><li>-Make appropriate arrangements with management or the Finance and Audit Committee to obtain the other information prior to the report release date.</li></ul></li><li>— Any material inconsistencies or misstatements of fact that are not resolved prior to the report release date, and that require revision of the other information, may result in KPMG modifying or withholding the auditors' report or withdrawing from the engagement.</li></ul>
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## Required communications and other matters

# Responsibilities (continued)

<b>KPMG responsibilities – Communications</b>	<ul style="list-style-type: none"><li>— Communicating significant matters related to the financial statement audit that are in our professional judgment, relevant to the responsibilities of the Finance and Audit Committee in overseeing the financial process. U.S. GAAS does not require us to design procedures for the purpose of identifying matters to communicate to the Finance and Audit Committee</li><li>— Communicating, unless prohibited by law or regulation, if we suspect or identify noncompliance with laws and regulations exist, unless matters are clearly inconsequential</li><li>— Communicating to management and the Finance and Audit Committee in writing all significant deficiencies and material weaknesses in internal control identified during the audit, including those that were remediated during the audit and reporting to management in writing all deficiencies noted during our audit that, in our professional judgment, are of sufficient importance to merit management's attention. The objective of our audit of the financial statements is not to report on the USDA's internal control</li><li>— Conducting the audit in accordance with professional standards and complying with the rules and responsibility of the Code of Professional Conduct of the American Institute of Certified Public Accountants and the official standards of relevant CPA Societies, and relevant state boards of accountancy</li><li>— Communicating to the Finance and Audit Committee circumstances, if any, that affect the form and content of the auditors' report</li><li>— Communicating if we plan to withdraw from the engagement and the reasons for the withdrawal</li><li>— Communicating to the Finance and Audit Committee if we conclude no reasonable justification for a change to the audit engagement exists and we are not permitted by management to continue the original audit engagement</li><li>— Communicating to the Board of Trustees in writing any conclusion(s) that the Finance and Audit Committee's oversight of external financial reporting and internal control over financial reporting is ineffective</li><li>— When applicable, we are also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement</li><li>— Communicating if we have identified or suspect fraud involving: (a) management, (b) employees who have a significant role in internal control, (c) others, when the fraud results in a material misstatement in the financial statements, and (d) other matters related to fraud that are, in the auditors' professional judgment, relevant to the responsibilities of the Finance and Audit Committee</li><li>— Communicating significant matters arising during the audit in connection with the USDA's related parties.</li></ul>
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## Independence

# KPMG independence quality controls

**KPMG maintains a comprehensive system of quality controls designed to maintain our independence and to comply with regulatory and professional requirements.**

- Submission of all worldwide engagements through Sentinel, a KPMG independence and conflict checking system (includes services for/relationships with the audit client, its affiliates, and its affiliated persons)
- Tracking partner rotation requirements using PRS (Partner Rotation System), the firm's automated partner rotation tracking system
- Automated investment tracking system used by all KPMG member firms (KICS)
- Training and awareness programs, including a required annual independence training deployed globally
- Annual independence confirmation required for all existing partners and employees and for all new individuals who subsequently join the firm
- Compliance testing programs
- Formal disciplinary policy and process
- Annual reporting to the Finance and Audit Committee regarding independence



# Independence of mind and appearance

- Independence consists of independence of mind and in appearance. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of the firm or members of the audit engagement team is compromised.
- Close personal relationships between firm personnel and audit client personnel can impact the appearance of independence or an auditor's independence of mind.
- KPMG has issued reminders and conducted training regarding KPMG's existing policies that require interactions between firm personnel and audit client personnel (including client entertainment) be directly related to a business purpose, reasonable, and infrequent (i.e. generally no more than four times a year). Additionally, firm policies prohibit the receipt or granting of any gift with a value in excess of \$100 between firm and audit client personnel.

# Breaches of independence

## **KPMG policies regarding breaches of independence:**

- For any breaches of the Independence rules, as soon as practicable KPMG will:
  - Assess the impact of the breach
  - Identify the actions performed or to be performed to address the consequences of the breach
  - Communicate in writing and discuss the breach and actions to address the breach with the Finance and Audit Committee
  - Obtain concurrence from the Finance and Audit Committee on the auditor's conclusion regarding the breach (i.e. that the actions taken satisfactorily address the consequences of the breach and the impact of the breach on KPMG's objectivity and impartiality with respect to the audit)
  - Document the details of the breach, the actions described above and the result

## Required communications and other matters

# Inquiries

<b>Finance and Audit Committee inquiries</b>	<ul style="list-style-type: none"><li>— Is the Finance and Audit Committee aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws and regulations?</li><li>— What are the Finance and Audit Committee's views about fraud risks in the UDSA?</li><li>— Does the Finance and Audit Committee have knowledge of fraud, alleged fraud, or suspected fraud affecting the Authority?</li><li>— Who is the appropriate person (Finance and Audit Committee chair or full Finance and Audit committee) for communication of audit matters during the audit?</li><li>— How are responsibilities allocated between management and the Finance and Audit Committee?</li><li>— What are the UDSA's objectives and strategies and related business risks that may result in material misstatements?</li><li>— Are there any areas that warrant particular attention during the audit and additional procedures to be undertaken?</li><li>— Is the Finance and Audit Committee aware of any significant communications with regulators?</li><li>— What are the Finance and Audit Committee's attitudes, awareness, and actions concerning (a) the UDSA's internal controls and their importance in the UDSA's, including oversight of effectiveness of internal controls, and (b) detection of or possibility of fraud?</li><li>— Is the Finance and Audit Committee aware of any developments in financial reporting, laws, accounting standards, corporate governance, and other related matters?</li><li>— Have there been any actions taken based on previous communications with the auditor?</li></ul>
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