

2009 financial statement audit plan



December 8, 2009

The Advisory Committee

Texas Regional Entity

Dear Members of the Advisory,

On December 14, 2009, we are meeting with you to discuss our audit approach and current year audit plan for TRE. We will outline the scope of our services, identify the Ernst & Young team that will serve you and present some key considerations that will affect the 2009 audit. We are providing the enclosed materials so you can familiarize yourselves with them prior to our meeting.

Our audit is designed to express an opinion on the 2009 consolidated financial statements as of December 31, 2009. We are currently completing the planning phase of our audit. We will consider TRE's current and emerging business risks, assess those that could materially affect the financial statements and align our procedures accordingly. The plan will be responsive to your needs and will maximize audit effectiveness so we can deliver the high quality audit you expect.

TRE selected Ernst & Young to perform its 2009 audit and we appreciate your confidence. Our commitment to quality will be reflected in every aspect of our work.

Very truly yours,

A handwritten signature in black ink, reading 'Philip J. Gunn'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Philip J. Gunn

## Deliverables

Global audit methodology

Continuous communication and relevant insight

Appendix A — Timing of required communications

Appendix B – Independence

Appendix C – Ernst & Young's Quality Control Procedures

	<ul style="list-style-type: none"> <li>• Express an opinion on the consolidated financial statements of TRE</li> </ul>
	<ul style="list-style-type: none"> <li>• Issue a written communication to management and the audit committee describing significant deficiencies and material weaknesses , if any, identified during our audit</li> <li>• Issue a management letter, if appropriate, that provides our recommendations regarding internal controls and opportunities for improvement or efficiency, based on observations made during the course of our audit</li> </ul>

## Overview of the audit process



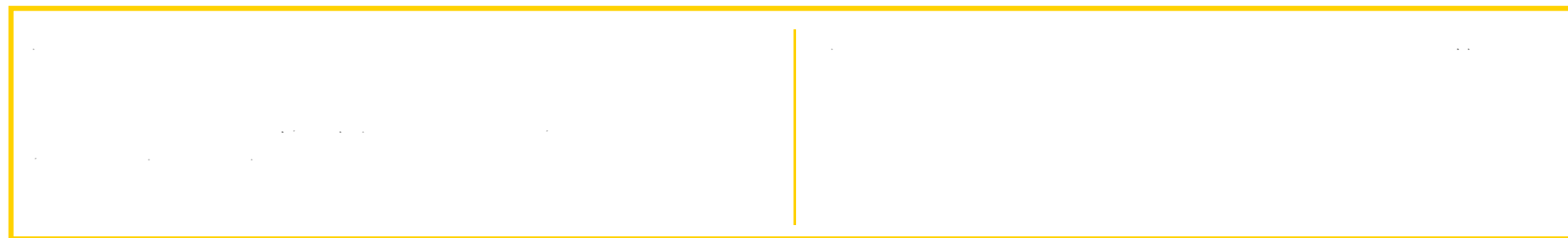
Important planning matters for audit committee consideration

- Accounting and auditing developments
- Areas of audit emphasis
- Fraud considerations and the risk of management override

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	<p>In March 2009, the Board issued an ED, <i>The Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162</i></p> <ul style="list-style-type: none"> <li>Amends FASB Statement No. 162, <i>The Hierarchy of Generally Accepted Accounting Principles</i>, to allow the Codification to become the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities, other than guidance issued by the SEC</li> <li>As proposed, would be effective on 1 July 2009; however in subsequent Board meeting, clarified as effective for financial statements for interim or annual periods ending on or after 15 September 2009</li> </ul> <p>The Codification will supersede current US GAAP, including FASB, AICPA, EITF and related literature</p> <p><b>Not intended to change US GAAP</b></p> <p>Reorganizes thousands of US GAAP pronouncements into approximately 90 accounting topics</p>	<p>The new ED will require a significant change in research of accounting issues and references to the accounting literature</p> <p>Expected benefits of the Codification include:</p> <ul style="list-style-type: none"> <li>Reduced time and effort required to research an accounting issue and improve usability of the literature</li> <li>Mitigate the risk of noncompliance with standards</li> <li>Note: The current references in this report are pre-codification.</li> </ul>
	<ul style="list-style-type: none"> <li>SFAS 165 specifically addresses guidance surrounding subsequent events that was previously considered only in auditing literature, and requires disclosure of the date through which subsequent events were considered</li> </ul>	<ul style="list-style-type: none"> <li>Adoption will necessitate additional disclosure in the Company's Year-end financial statements.</li> </ul>

## Areas of audit emphasis include:

- Revenue recognition – Testing of statutory revenues
- Cash and equivalents, and investments
- Systems under Development
- Accrued liabilities
- Regulatory liabilities
- Expenses (including allocations)



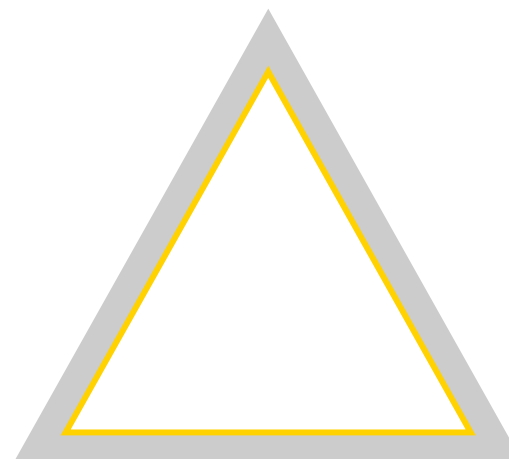
We evaluate the risk of fraud, including the risk of management override, using the fraud triangle and consider the actions management has taken to respond to those risks.

We consider, among other things:

- Code of conduct/ethics
- Effective and independent oversight by audit committee
- Process for dealing with whistle-blower allegations
- Adequacy of internal audit oversight of activity
- Entity's risk assessment processes

Role and oversight responsibilities of the audit committee:

- Management's assessment of the risks of fraud
- Programs and controls to mitigate the risk of fraud
- Process for monitoring multiple locations for fraud
- Management communication to employees on its views on business practices and ethical behavior



*Occupational Fraud and Abuse*, by Joseph T. Wells, CPA, CFR  
(Obsidian Publishing Co, 1997);  
*Fraud Examination*, by W. Steve Albrecht (Thomson South-Western Publishing, 2003)



## Ernst & Young's thought leadership

### **BoardMatters Quarterly** — contains articles on:

- The company's ability to continue as a going concern
- Preparing for this year's shareholder meeting
- Transacting in turbulent times
- New rules in accounting for business combinations
- Financial communications in today's world
- IFRS comment period extended
- Managing through a downturn
- Fair value accounting: The debate continues
- Cash flow crisis? Managing cash and treasury functions is more important than ever
- Counterparty risk: Lessening your company's exposure
- Enterprise risk oversight: New considerations for the audit committee
- Effectiveness and accountability in the boardroom

**Ernst & Young AccountingLink** — All leading US technical guidance and thought leadership

**New audit committee site on ey.com** – [www.ey.com/auditcommittee](http://www.ey.com/auditcommittee)

### **Tax alerts, international tax conference**

**ThoughtCenter Webcasts** — Webcasts produced and hosted by Ernst & Young that feature Ernst & Young's best thought leaders, experienced industry advisors and subject-matter professionals. Browse the webcast archive on our website ([www.ey.com](http://www.ey.com)) by industry or topic.

### **Industry publications**

- Industry 360 – The Ernst & Young source for global industry insights
- Team to customize

**Tapestry Networks** — Ernst & Young works with Tapestry Networks to orchestrate private dialogues, including the Audit Committee Leadership Network (ACLN), and to develop practical insights and solutions to help enhance the functioning of financial markets. The ACLN is a group of audit committee chairs from some of America's leading companies.

## Timing of required communications

Our responsibility under GAAS and/or PCAOB standards, including other information in documents containing audited financial statements		<b>X</b>
Major issues discussed with management in connection with initial or recurring retention	<b>X</b>	
Significant audit adjustments		<b>X</b>
Unrecorded audit differences considered by management to be immaterial		<b>X</b>
Our judgments about the quality of the Company's accounting principles		<b>X</b>
Disagreements with management	<b>X</b>	
Consultations with other accountants	<b>X</b>	
Serious difficulties encountered in dealing with management when performing the audit	<b>X</b>	
The adoption of, or a change in, an accounting principle	<b>X</b>	
Methods of accounting for significant unusual transactions and for controversial or emerging areas	<b>X</b>	
Sensitive accounting estimates		<b>X</b>
Fraud and illegal acts involving senior management and fraud and illegal acts that cause a material misstatement of the financial statements	<b>X</b>	
Significant deficiencies and material weaknesses identified during audit		<b>X</b>

Overview of planned scope and timing of the audit		<b>X</b>
Representations the auditor requests from management		<b>X</b>
Significant findings or issues arising from the audit that were discussed with management		<b>X</b>
Events or conditions that cause us to conclude that there is substantial doubt about the entity's ability to continue as a going concern	<b>X</b>	



Auditor independence rules are founded on four general principles – that auditors and their clients engage in no relationship or provision of service that, in either fact or appearance:

- Creates a mutual or conflicting interest between the auditor and the audit client
- Places the auditor in the position of auditing his or her own work
- Results in the auditor acting as management or an employee of the audit client
- Places the auditor in a position of being an advocate for the audit client

Based on these general principles, independence rules can be summarized within two categories: **Relationships** and **Services**

▶ [Learn more about our services](#)

- ▶ partner compensation –

## Ernst & Young's

Independence is fundamental to EY, our audit clients, and the public interest. Our approach to maintaining independence includes implementing policies, processes and systems with both “prevent” and “detect” type controls to provide reasonable assurance that a breach of independence will not occur and, in the event one does, will not go undetected nor unremediated. We proactively reexamine, monitor and test our policies, processes and systems so that they are current, thorough and effective. We reinforce our policies, processes and systems through continuous independence training of our professionals. We continually reinforce to all our people that compliance with our independence policies is essential, and that non-compliance has consequences.

- ▶ Establishing a strong culture of independence
- ▶ Implementing robust policies, processes and systems
- ▶ Proactively reexamining, monitoring and testing our policies, processes and systems

- ▶ Monitoring of compliance with our firm's independence policies
- ▶ Reinforcing the importance of independence to all our people
- ▶ Providing continuous independence training
- ▶ Ensuring that non-compliance has consequences

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## Ernst & Young's Quality Control Procedures



# ernst & young's

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Our reputation for providing quality professional services in an independent, objective, and ethical manner is key to our success as independent auditors. Our strong commitment to quality services has led the firm to adopt a comprehensive set of quality control policies and other safeguards that are applicable to every audit engagement. Like any other system of internal control, no single control or safeguard provides us with the assurance that our professionals comply in all instances with applicable professional standards and the firm's standards of quality. Working in tandem, however, these controls and safeguards provide a comprehensive system that serves to prevent or detect in a timely manner matters that without corrective action could result in substandard performance. As a result, we believe that the firm's system of quality control for our accounting and auditing practice meets the requirements of quality control standards adopted by the Public Company Accounting Oversight Board for a public company accounting and auditing practice. The following is a summary description of some of Ernst & Young's quality control policies and other safeguards for our accounting and auditing practice.

**Tone at the top** — Ernst & Young's Executive Board and senior management regularly communicate and reinforce the firm's expectations and the importance of performing quality work and complying with the firm's policies. The Ernst & Young culture strongly supports collaboration and consultation and places special emphasis on the importance of consultation in dealing with complex and/or subjective accounting, auditing, reporting, SEC and independence matters. We also emphasize the importance of determining that the client has correctly followed our advice when necessary.

**Organizational structure built around quality** — Reflective of our commitment to quality, the firm's Quality and Risk Management (Q&RM) function, led by one of the firm's vice chairs, is responsible for overseeing firm-wide quality initiatives in each of our service lines. For example, the Q&RM group is responsible for establishing firm policies and processes and consulting on independence matters for all of our service lines.

The independence function within the Q&RM group is comprised of a dedicated centralized group of partners and professionals, as well as independence partners who are physically located in each of the firm's geographic operating sub-areas. They work closely with the technical resources located in our sub-area practices to identify and resolve independence issues affecting clients. The Vice Chair of Quality and Risk Management reports directly to the Chairman of the firm and is a member of the Executive Board.

The Assurance and Advisory Business Services (AABS) Professional Practice and Risk Management function, also led by one of the firm's vice chairs, is responsible for establishing firm policies and methodologies and consulting on accounting, auditing, and SEC reporting matters, as well as practice monitoring and risk management activities for our accounting and auditing practice. The Professional Practice and Risk Management function is comprised of highly-qualified, seasoned partners and senior managers in technical support groups such as the National Accounting group in New York, the National SEC group in Washington, and the National Standards & Methodology group in Cleveland. In addition, the Professional Practice and Risk Management function includes a National Professional Practice Director (PPD) network comprised of partners and senior managers physically located in each of the firm's geographic operating sub-areas. The PPD network is a key part of our consultation process so having them geographically located within the operating sub-areas helps the network be more knowledgeable about our people and clients, as well as more easily accessible for consultations with audit engagement teams and our clients. It is important to note that although the PPD network is located within the operating sub-area it is independent of the operating sub-area leadership. The partners in the network report to and are evaluated and compensated by the Vice Chair of AABS Professional Practice and Risk Management to provide greater assurance on the objectivity of our consultation process.

Given the volume and complexity of new accounting, reporting, and regulatory matters facing our audit engagement teams and our clients, we continue to evaluate our resources dedicated to improving the quality of our work and are committed to increasing them when needed.

**Code of professional conduct** — The Ernst & Young Code of Conduct was developed to provide an ethical framework for all of our activities. Each partner and employee are asked to sign an annual confirmation statement that they have read the Code of Conduct carefully, have become familiar with the elements of the Code, understand their responsibilities with respect to its requirements and agree to abide by its provisions as a condition of continued employment or association.

**Ethics hotline/website and Ethics Oversight Board** — The firm's leadership has clearly communicated to our partners and employees an expectation of personal responsibility to pursue an understanding of any matter pertaining to ethics. Although, in most instances consultation with client service partners, business unit leaders, or others will resolve a matter, our EY/Ethics Hotline and EY/Ethics website, which supplements the phone-based hotline, were designed to provide another — and confidential — way for our people to raise concerns about unethical or illegal actions, violations of professional standards, or other actions inconsistent with the Ernst & Young Code of Conduct. In addition, our Ethics Oversight Board, reporting directly to the Executive Board and comprised of senior partners in the firm, provides ongoing monitoring of the practices and principles that guide the way we do business.

**Independence** — Ernst & Young has a comprehensive set of independence policies. The firm's written policies cover relationships with restricted entities (e.g., audit clients) as well as all other professional and regulatory independence requirements. Our independence policies and processes comply with the SEC's auditor independence rules. Compliance with the firm's policies and procedures is tested in several ways. Professionals who do not comply with professional or regulatory requirements are subjected to disciplinary sanctions.

**Document retention** — The firm has a comprehensive Retention of Records policy that applies to all of our service lines. This policy is intended to ensure that professional standards on working papers are complied with and that appropriate documents are retained as long as necessary for business, legal and regulatory purposes. The policy emphasizes that all documents must be preserved whenever any person becomes aware of any actual or reasonably anticipated claim, litigation, investigation, subpoena or other government proceeding involving Ernst & Young or one of our clients that may relate to our work.

**Audit methodology** — As a result of substantial investment and our focused efforts to continually maintain state-of-the-art audit methodologies and supporting tools, our auditors are well equipped to perform audits of the financial statements of companies of varying sizes and complexities, including integrated audits of internal controls over financial reporting when required. The Ernst & Young Global Audit Methodology provides a framework for application of a consistent thought process to all audits. The methodology contemplates team-based audit service delivery and allows alternative solutions depending on client circumstances, professional judgment and audit team input. We make enhancements to our audit methodology on a regular basis as a result of new standards, emerging auditing issues or implementation experiences.

**Technology enablers** — Numerous technology enablers are used by our audit engagement teams to assist in executing and documenting the work performed in accordance with the Ernst & Young Global Audit Methodology.

**Formation of audit engagement teams** — Ernst & Young requires an annual review of partner assignments for public companies by geographic operating sub-area leadership and the National Professional Practice Directors located in the geographic operating sub-areas to make sure that the partners serving our public company clients possess the appropriate competencies to fulfill their engagement responsibilities.

**Reviews of audit work** — Firm policies describe the requirements for timely, direct executive participation on audits and various levels of reviews of the work performed.

**An independent look at all our audits** — A professional and regulatory requirement for audits of public companies is that a partner independent of the audit team reviews the audit report on the financial statements (and where applicable the audit reports on internal controls over financial reporting) and performs certain other procedures prior to issuance of the report(s). We require such reviews on all audits, of both public and private companies.

**Consultation requirements** — Our consultation processes and related policies are designed to take advantage of all of the firm's resources in reaching our conclusions on complex and/or subjective accounting, auditing, reporting, SEC and independence matters. Consultation is a decision-making process, not just a process to provide advice. For complex and sensitive matters, Ernst & Young requires consultation outside of the audit team with other personnel who have more experience or specialized knowledge, with the goal of deciding the appropriate firm position regarding these matters. We have an extensive list of matters that require consultation on any engagement where the situation is encountered, and we supplement the list of required consultations to focus on emerging matters. Our people are expected to, and do, consult regularly on other significant accounting, auditing, reporting, SEC and independence matters, as well as on other sensitive issues or sensitive communications to clients or others outside the firm.

**Audit engagement team disagreement resolution process** — Ernst & Young has a collaborative culture and encourages its people to speak up if a professional-practice disagreement arises or they are uncomfortable about something having to do with a client engagement. The firm's policies provide all of our people with the authority to demand a hearing for their views and an understanding that the firm considers all points of view when resolving key issues. When a matter that goes beyond the audit engagement team is ultimately resolved, firm policies require it to be documented.

**Audit partner rotation** — As required by the SEC's independence rules, on audit engagements for public companies our firm will rotate the lead audit partner, the reviewing partner (i.e., partner independent of the audit team), and other audit partners (as defined) no less frequently than the maximum years of service permitted by the SEC.

**Conflicts resulting from employment relationships** — Ernst & Young has policies and procedures to address the potential for actual or perceived impairment of independence for situations where the firm's professionals accept employment at the firm's audit clients. Our policies in this area address the SEC's one-year cooling off requirement, and set forth consultation protocols within the firm for certain job positions so that compliance is achieved with respect to both the letter and the spirit of the SEC's rules.

**Partner evaluation and compensation methods** — Ernst & Young evaluates and compensates its partners based on several factors, which are aligned to the firm's overall strategy and direction. We do not compensate our audit partners on the sale or delivery of non-audit services to their audit clients. Our compensation approach reflects the firm's deep commitment to provide quality service to our clients as well as our professional obligation to maintain our independence.

**Staff evaluations** — Ernst & Young's performance management and development process is designed to provide timely, specific feedback on job performance. The purpose of the process is to help our people grow in their careers and to understand how their personal development is linked to the firm's values, strategy and overall success.

**Client acceptance and continuance** — Ernst & Young's audit client acceptance process involves a careful consideration of the risk characteristics of a prospective client and several due diligence procedures. Our approval process is rigorous, and no new audit client may be accepted without the prior approval of the National PPDs located in the geographic operating sub-areas. Additionally, as part of audit client acceptance, an independence review is performed prior to accepting an initial engagement pursuant to the standards of the PCAOB. The National PPDs also are very involved in the client continuance process and must be satisfied with the geographic operating sub-area leadership's decisions. Both client acceptance and client continuance decisions depend on, among other things, the absence of any perception that a company's management pressures the audit engagement team to accept inappropriate accounting and reporting. Our considerations and conclusions on the integrity of management are essential to our acceptance and continuance decisions.

**Internal and external practice monitoring** — Ernst & Young conducts an annual internal inspection program (Assurance Quality Review or AQR) that assesses the quality of our audit work for a cross-section of engagements. The objective of the AQR program is to evaluate the design and operating effectiveness of the firm's quality control policies and procedures for our accounting and auditing practice. The AQR program also aids our efforts to continue to identify areas where we can improve our performance or enhance our policies and procedures.

The PCAOB performs annual inspections of the firm's public company accounting and auditing practice and our non-public company practice is reviewed on a triennial basis as part of the AICPA peer review program.

**Recruitment and hiring** — One of Ernst & Young's strategic objectives is to attract and build lifelong relationships with extraordinarily talented people. For the most part, the firm hires only candidates who have qualified academically to sit for the CPA examination in the state for which they are being recruited.

**Professional development** — Ernst & Young has requirements for continuing professional education that apply to all professionals. Our commitment to lifelong learning results in an improved ability to meet personal and professional goals and provide the highest quality service to our clients. An individual's professional development principally occurs through formal learning and on-the-job training. The core training courses are supplemented by training programs that are developed in response to changes in accounting and reporting standards, professional standards, and emerging practice issues.

**Communication technology and knowledge databases** — Ernst & Young makes significant investments in its knowledge and communications networks to assist our professionals. Examples of electronic mail communications and knowledge databases are: a daily newsletter that reports on the latest news and information about the firm and its services, a periodic newsletter that reports on recent accounting and auditing standard-setter activities and other important matters, and several intranet repositories providing information on important accounting, auditing and industry related topics.

#### **Peer review, internal quality control review and other inquiries —**

[Client team TBD — Note: For New York Stock Exchange listed companies, audit committees are required to obtain and review annually a report by the independent auditor that includes a description of any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with such issues. Audit teams may communicate this information anytime throughout the year. Audit teams who elect to include this communication as part of the audit plan or results should refer to the latest version of the *Report for Audit Committees: Information on Ernst & Young's Accounting and Auditing Practice* to complete this section.

As of November 2008, the most recent version of this report is included in Information Release No. BB1627.]

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Strong independent assurance provides a timely and constructive challenge to management, a robust and clear perspective to audit committees and critical information for investors and other stakeholders. The quality of our audit starts with our 60,000 assurance professionals, who have the experience of auditing many of the world's leading companies. We provide a consistent worldwide audit by assembling the right multidisciplinary team to address the most complex issues, using a proven global methodology and deploying the latest, high-quality auditing tools. And we work to give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our work worldwide. It's how Ernst & Young makes a difference.