Committee Member Training

Rebecca Beckham
Manager, Accounting

Finance and Audit Committee Meeting
July 16, 2012

Electric Reliability Council of Texas, Inc.
Statements of Financial Position
As of June 30, 2012 and 2011
($ in Thousands)

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 177,256	$ 225,788
Accounts receivable	6,237	12,423
Unbilled revenue	14,166	12,897
Restricted cash	448,767	350,057
Prepaid expenses and other current assets	16,779	16,478
Total current assets	663,205	617,643
Property and equipment, net	332,593	413,961
Systems under development	8,598	12,349
Debt issuance cost	257	397
Total assets	$ 1,004,653	$ 1,044,350
Liabilities and Unrestricted Net Assets		
Current liabilities:		
Accounts payable	1,819	1,777
Accrued liabilities	8,260	13,691
Deferred revenue	3,438	3,153
Market settlement liabilities	221,141	275,406
Security deposits	448,767	350,057
Notes payable, current portion	139,470	164,470
Total current liabilities	822,895	808,554
Notes payable	13,630	98,100
Derivative liability	1,193	6,869
Regulatory liabilities	137,083	96,343
Other long term liabilities	389	322
Total liabilities	975,190	1,010,188
Unrestricted net assets	29,463	34,162
Total liabilities and unrestricted net assets	$ 1,004,653	$ 1,044,350

Electric Reliability Council of Texas, Inc.
Statements of Activities
For the Six Months Ended June 30, 2012 and 2011
($ in Thousands)

	2012	2011
Operating revenues		
System administration fees	$ 64,766	$ 65,900
Nodal implementation surcharge	58,292	59,365
Reliability organization pass-through	6,531	5,987
Membership fees and other	2,595	1,645
Total operating revenue	132,184	132,897
Operating expenses		
Salaries and related benefits	36,183	34,717
Depreciation	16,760	17,635
Facility and equipment costs	6,461	6,136
Outside services	6,693	4,025
Hardware and software maintenance and licensing	10,088	5,425
Reliability organization assessment	6,531	5,987
Other	2,682	2,218
Amortization of regulatory asset	58,292	59,365
Total operating expenses	143,690	135,508
Loss from operations	(11,506)	(2,611)
Other income (expense)		
Interest income	2	3
Interest expense	(1,824)	(2,083)
Change in valuation of interest rate swap	2,043	2,963
Non-operating income	266	8
Change in unrestricted net assets before deferred pension costs	(11,019)	(1,720)
Deferred pension costs	11	9
Change in unrestricted net assets	(11,008)	(1,711)
Unrestricted net assets, beginning of year	40,471	35,873
Unrestricted net assets, end of period	$ 29,463	$ 34,162

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Reputational risk: Protecting the good name and reputation of the not-for-profit organization and its board (CPE credits: 1.5)

- Bookmark/Share
- Email

Date: Wednesday, July 25, 2012
Time: 1:00 - 2:30 pm ET
CPE: 1.5

This presentation is part of Grant Thornton's Board Member Webcast Series.

Grant Thornton will present its newest whitepaper on reputational risk management with a focus on board members' responsibilities. This webcast, **Reputational risk: Protecting the good name and reputation of the not-for-profit organization and its board**, will discuss policies, protocols and procedures that should be considered to protect the good name and reputation of the organization, its governing board and its management team. The discussion will center around how organizations can be proactive rather than reactive to managing reputational risk.

We hope you will be able to join us. This webcast will be hosted by **Frank Kurre**, national managing partner of Grant Thornton's Not-for-Profit and Higher Education practice, and **Mark Oster**, principal-in-charge, National Not-for-Profit and Higher Education Business Advisory Services Practice.

Returning users

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New users

1. Create your account.
2. Complete all of the required fields.
3. Locate the webcast, **ID: 36457, Reputational risk: Protecting the good name and reputation of the not-for-profit organization and its board**, in the catalog and press the 'Enroll' button.
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If you have any questions or encounter any technical difficulties while enrolling, please contact LearnLive technical support at 888.228.0988 or email GT_support@learnlive.com.

- **Location:** Online
- **Type:** Webcast
- **CPE Credits:** 1.5
- **Start Time:** Wednesday, July 25, 2012 1:00 pm ET
- **End Time:** Wednesday, July 25, 2012 2:30 pm

Roles and responsibilities of the not-for-profit audit committee (CPE credits: 1.5)

- Bookmark/Share
- Email

Date: Thursday, October 18, 2012
Time: 1:00 - 2:30 pm ET
CPE: 1.5

This presentation is part of Grant Thornton's Board Member Webcast Series.

Members of a not-for-profit's audit committee have an important function in risk management and preventing financial oversight. This webcast, **Roles and responsibilities of the not-for-profit audit committee**, will present best practices for how an effective audit committee should operate. Specific responsibilities of the nonprofit audit committee as wells as trends in how these committees operate will also be discussed.

We hope you will be able to join us. This webcast will be hosted by **Frank Kurre**, national managing partner of Grant Thornton's Not-for-Profit and Higher Education practice, and **Mark Oster**, principal-in-charge, National Not-for-Profit and Higher Education Business Advisory Services Practice.

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- **Location:** Online
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June 2012

BoardMatters Quarterly

Critical insights for today's audit committee

Examining the modern audit committee

Today's audit committee is tasked with an overwhelming amount of responsibility. Members are under considerable pressure to understand and monitor all types of risk, while also overseeing the financial reporting process and the internal audit function, managing the external auditor relationship, supporting growth and more. This issue of *BoardMatters Quarterly* shares how some audit committees are managing the workload and getting things accomplished. We also take a look at audit committee charters to see how audit committees are governing themselves, and we discuss the possible benefits and considerations related to using outside advisors to help with complex issues and challenges. Finally, we review the current regulatory landscape and possible changes to the financial reporting process.

In this issue

If you have feedback or ideas for future topics, please contact Sara Brandfon at sara.brandfon@ey.com.

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Quality In Everything We Do

Beyond the ordinary

Unique approaches to today's audit committee challenges

Many of today's corporate boards are challenged with expanding agendas, shifting economic conditions and emerging risks. They also are under enormous pressure from regulators, investors and shareholders. These challenges are particularly significant for audit committees, which also must oversee risk, the independent auditor and internal auditor, and the company's accounting and financial reporting processes.

To help meet some of the demands, some audit committees are thinking in unique and practical ways about managing agendas, improving transparency and identifying efficiencies.

Getting a hands-on perspective

First and foremost, the audit committee must have a thorough understanding of the business and the financial accounting policies and procedures. One way audit committees can better understand the financial reporting process is to have each committee member spend a day with the teams from internal audit, corporate accounting and the independent auditor. During these meetings, the teams cover critical accounting and financial reporting topics to help the audit committee members understand the depth of their knowledge and their unique perspectives and insights into the company.

The audit committee is responsible for managing the relationship with the independent auditor and ensuring that the auditor conducts a high-quality audit. Establishing good communication and regular interaction can go a long way in helping both the auditor and the audit committee meet their responsibilities. However, it's important that the broader board also understands the role of the independent auditor. To that end, some boards have found it extremely valuable to have the auditor play a part in the orientation of each new board member. This orientation gives new directors the opportunity to have one-on-one conversations with the auditor and better understand and ask questions about risk areas and critical accounting policies used to prepare the company's financial statements.

For audit committees of global companies, having experience with foreign cultures and knowledge of international business matters can help members better understand and monitor the risks in distant locations. This experience is particularly important when it comes to emerging markets. An increasing number of audit committees are conducting meetings in international locations where members gain firsthand knowledge of the market, meeting with local management and independent audit teams in those locations.

Managing the agenda and materials

With so many issues needing attention and sometimes competing priorities, audit committees are looking for more efficient ways to gather

information quickly and accurately in order to focus the agenda and make meetings more productive.

Many audit committees find it beneficial to invite the CFO's direct reports to present, at least annually, to the committee on risks, emerging trends and the challenges they face. Having these individuals prepare and distribute their reports in advance is even more helpful, so that more time can be spent asking and answering questions.

Similarly, some audit committees ask business unit leaders to make presentations on risks specific to their areas, such as tax, IT, people or operations. These presentations allow the audit committee to develop a relationship with the CFO and business unit leaders, provide the committee with insight into the "bench strength" in these functional areas and allow the committee to better understand future succession needs.

Internal audit helps identify high-risk priorities for the audit committee. For example, some internal audit directors have "high-risk reporting" categories, and if certain areas are identified, the appropriate team or responsible individual presents a responsive action plan to the audit committee.

What the audit committee chair can do

The audit committee chair plays an important role, not only in leading the committee but also in setting the tone of the relationship with management and the independent auditor.

Some chairs develop a personal mentoring relationship with the CEO and/or the CFO and have regular one-on-one meetings with those individuals. Other chairs meet individually with the controller, the chief accounting officer and the independent auditor before every audit committee meeting, not just occasionally.

Further, some audit committee chairs like to meet with departments and teams that might not normally present to the audit committee, such as marketing. These sessions can provide valuable insight into the company's operations, products and strategies — all of which can help the audit committee in its broader governance role.

To improve transparency, many audit committee chairs invite the entire board, the chairman and, in some cases, the CEO to each meeting. Having an open-door policy increases the flow of information and ultimately may provide additional input and greater perspective on certain issues.

Working with the CFO

The CFO plays a critical role in the financial reporting process. Some CFOs have enhanced open dialogue with committee members by preparing a list of new disclosures for discussion with the audit committee. Some CFOs also meet regularly with the audit committee chair to review the risks to which the

company is exposed and make this a regular topic of discussion with the entire audit committee.

At some companies, controllers create a summary review document describing the critical accounting estimates used in the financial statements. The CFO reviews the summary and sends it to the independent auditor before each quarterly meeting. With each of these examples, the CFO helps to focus the audit committee's attention on specific risks the company faces and the appropriate accounting for and disclosure of those matters.

Applying what works

Serving on an audit committee requires a significant time commitment and involves taking on serious responsibilities. Considering and applying some of the practices summarized here may help audit committees deal with current issues and be better prepared for future challenges. ■

Questions for the audit committee to consider

- Do any members sit on other audit committees? If so, what leading practices can they share?
- How often does the audit committee meet with teams (e.g., IT, compliance, tax, internal audit), formally or informally, to better understand the risks and challenges the company faces?
- Are all board and audit committee members familiar with the accounting policies and procedures, and do they have access to, or regular interaction with, the independent auditor?
- If the company has operations in other locations (e.g., foreign countries), should the audit committee or board consider meeting in those locations?
- Does the audit committee chair meet with the controller, chief accounting officer, internal auditor and/or independent auditor before every audit committee meeting?
- Should the audit committee invite the entire board or C-suite to committee meetings?

What's in your charter?

A review of the audit committee charters of the largest companies

An audit committee charter summarizes the roles and responsibilities of the committee and outlines its scope, structure and processes. Modern charters have their origins in U.S. Securities and Exchange Commission (SEC) and stock exchange listing rules that were intended to improve audit committee effectiveness. Charters were later standardized by the Sarbanes-Oxley Act of 2002. Charters must address the following at a high level:

- Audit committee membership criteria focused on independence and composition
- The relationship between the audit committee and the independent auditor
- Procedures regarding accounting, internal controls and audit matters
- The authority of the committee to engage independent counsel and other advisors

In general, an audit committee must maintain and assess its charter annually and disclose the charter at least once every three years. These requirements help investors and regulators understand and evaluate an audit committee's specific roles and responsibilities, as well as its approach to risk oversight. Nearly half of Fortune 100 companies disclosed that they updated their audit committee charters in the last 18 months (see Figure 1).

Also, most charters set the minimum number of audit committee meetings required per year, which is typically four (see Figure 2). But in practice, most committees meet much more often. For S&P 100 companies in 2011, the median number of meetings was nine.[3]

Figure 1: Last update to charter[1]

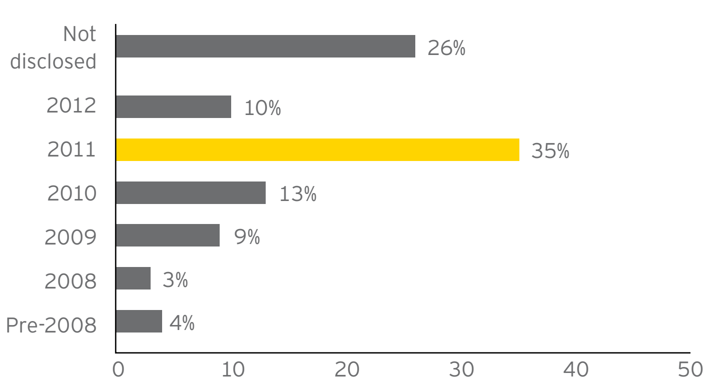
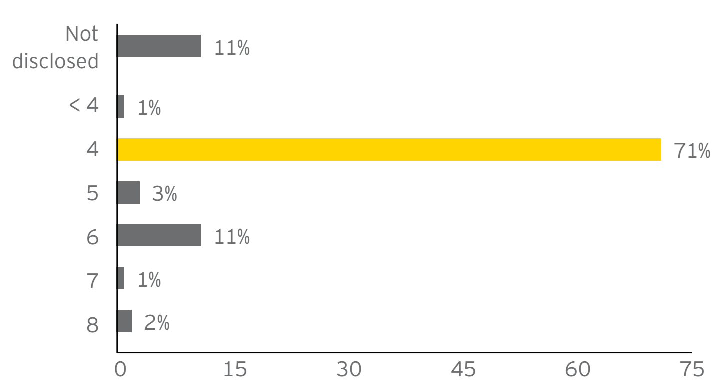


Figure 2: Minimum number of audit committee meetings required by the charter[2]



> While similar provisions appear in all charters, each audit committee should tailor its charter to meet the unique characteristics of its company.

We recently reviewed the current audit committee charters of the 92 publicly traded Fortune 100 companies. We looked at how the charters addressed more than a dozen topics related to audit committee members and their responsibilities, including:

- The responsibilities of the audit committee chair
- The appointment and removal of audit committee members
- The relationship between the audit committee and the head of internal audit

Our review shows that most charters go beyond the minimum requirements when defining the roles and responsibilities of audit committees. The SEC has acknowledged that while similar provisions appear in all charters, each audit committee should tailor its charter to meet the unique characteristics of its company, including size, industry and organization structure. Some charters stand out by providing a more strategic perspective and purpose. Committees that create these charters use them to set the tone at the top for considering risk, and to communicate that "risk" may include non-traditional matters, such as corporate sustainability.

Most committees doing more than expected

The vast majority of audit committee charters go beyond the minimum requirements. For example:

- Three-quarters state that revisions to the charter require approval from the board or governance committee. One-third of the charters require the committee to conduct a self-evaluation at least annually and to present the results to the board or governance committee. Involving the board or governance committee in charter revisions and the performance review produces greater board involvement.
- Two-thirds discuss that the committee may appoint and remove individual committee members, and some explicitly state that the board may remove the entire committee.
- Nearly half of the charters augment the audit committee's basic authority to retain outside experts and advisors by emphasizing that the committee can conduct special investigations and/or has access to all personnel, books, records and facilities.

Where the biggest differences are — and potentially the greatest area for improvement

Some audit committee charters have significantly different language than other charters. For example, while almost two-thirds of the charters discuss the chair selection process, only about a third of the charters we looked at spell out the responsibilities of the audit committee chair, and these issues are defined and outlined in ways that are unique to the companies. It is important for

charters to address the duties of the audit committee chair, given the expectations for the chair in setting committee agendas, managing information flow and working with other committees.

A little more than a dozen of the 92 charters included in our review tailor the discussion of risk management to the company's specific circumstances, while the others rely on the standard language in regulatory and exchange listing requirements. And while audit committees frequently work with other board committees and business units, only about 10% formalize this interaction in their charters.

We also noted that less than one-quarter of the charters in our study give the audit committee oversight of compensation decisions for the head of internal audit. More than half of the charters provide a detailed discussion of the committee's authority to review the appointment or removal of that individual. Oversight of compensation is strongly tied to performance oversight.

While a handful of charters stood out by communicating higher expectations for accountability, engagement and performance, most of the charters we reviewed were inconsistent in addressing the full range of committee responsibilities. The quality of each charter depends on the efforts of the specific audit committee and the extent to which the committee is active and engaged in developing and modifying the charter. ■

Questions for the audit committee to consider

- When was the audit committee's charter last modified?
- Does the charter define the responsibilities of the audit committee chair?
- Is the charter tailored to reflect company-specific needs or is the language largely boilerplate and applicable to any company in any industry?
- Has the committee updated the charter for its risk oversight responsibilities, including those in non-traditional risk areas?

1 Based on disclosure on company websites; 2012 data as of 20 April.

2 Based on our April 2012 review of the audit committee charters of 92 publicly traded Fortune 100 companies.

3 *Corporate Governance Practices and Trends*, Fenwick & West LLP, 2011.

Engaging advisory boards

Forward View by Tapestry Networks

Directors recognize the importance of international markets to the future of their companies' businesses, but many agree that board members often lack the necessary expertise to understand their organization's international expansion and operations. As one audit chair in our network recently acknowledged, "We don't understand country risk trends very well. We talk about opportunities in China and elsewhere, but we don't talk about the risks. People know that, in general, China's a risk, but they say, 'Everyone's charging in, so we are charging in.'"

Indeed, the experience of many board members is limited to developed economies: by one estimate, only 6.6% of S&P 500 directors are non-US nationals, and of these, 45% are British or Canadian, 24% are continental European and less than 2% are Chinese or Japanese.[4]

Relying on advisory boards

To bring different perspectives into the boardroom, some boards are experimenting with "advisory boards" to help inform management and the board on significant trends and to help them tap into important relationship networks. An advisory board, if used appropriately, could be a great asset for the board and management. "Advisory boards typically have great contacts, and if you tailor the composition of the advisory board to what your business needs, they can be real strategic partners," an audit chair told us.

Directors acknowledge that the formation of some advisory boards has been poorly executed. Perhaps, as one director said, people join advisory boards for the prestige. However, if an advisory board operates correctly, it can provide significant value. Some questions to consider when forming an advisory board include:

- **What's the composition of the advisory board?** Advisory board members can be drawn from all facets of life, and mixing different types of expertise and experience is valuable. According to one audit chair,

Forward View is prepared by Tapestry Networks. Tapestry Networks organizes and leads nine audit committee networks with the active support and engagement of Ernst & Young that collectively consist of 150 individuals, who chair more than 200 audit committees and sit on more than 380 boards at some of the world's leading companies. Ernst & Young refers to the global organization of member firms of Ernst & Young Global Ltd., each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm in the US.

Tapestry Networks

An advisory board, if used appropriately, could be a great asset for the board and management.

his committee will probably set up an advisory board in a country that is strategically important to the company. As he explains, "We are just thinking it through now — Do we want retired government officials, key executives, university professors, or all of them? It's going to depend on what kind of insight we are looking for and how engaged the board members will be."

- **Who chairs the advisory board?** The advisory board should be chaired by an individual experienced in running meetings, prioritizing key initiatives, facilitating dialogue and leveraging key resources.
- **How does the advisory board prepare for meetings?** Pre-work is critical to the success of an advisory board. Advisory board members should prepare in advance for meetings so that they understand the issues. A clear agenda helps everyone understand the meeting objectives.
- **Who is being advised?** Advisory boards could support both the board of directors and management. In some cases, the advisory board could act as a mentor to country managers who are either opening an operation in a country for the first time or who are new to the country. "We expect that the country manager will interface with the advisory board," said one member of our network. "At the end of the day, it is going to be a local support group for the [local country] leadership." In other cases, the advisory board can help the board by providing an objective view of certain issues.

As international markets become increasingly critical for US companies, directors are looking to enhance their boards' international knowledge. Many directors say they need specialized counsel and advice delivered to management and the board in a more agile manner.

Advisory boards composed of prepared, thoughtful, engaged members can supplement the board's expertise. Ultimately, it may be worth experimenting with advisory boards in areas of a company that demand more expertise, such as technology change and risk management. As one audit chair said, "We are thinking of experimenting with an advisory board to help us with an enterprise risk area ... if it works out, it will be a huge benefit to us, and it if does not, it won't be a huge risk to us." ■

4 Craig Mellow, *It's Time to Recruit More Foreign Nationals as Directors*, Corporate Board Member, 5 August 2010.

Regulatory activity and possible financial reporting changes

Considerations for audit committees

Significant standard setting and legislative activity worldwide in recent months affects auditors and, by extension, the audit committee. Audit committees need to monitor these developments closely, share their views and understand the implications.

Audit committee matters

The Public Company Accounting Oversight Board (PCAOB) issued the concept release on auditor independence (the Concept Release) in August 2011. The Concept Release sought comments on possible ways to enhance auditor independence, objectivity and professional skepticism, including mandatory audit firm rotation and other alternatives.

In March 2012, more than 40 panelists participated in a two-day public meeting hosted by the PCAOB to discuss the Concept Release. Panelists included institutional investors, former government officials, audit committee chairs of major corporations, senior executives of issuers, representatives from trade associations, academics and senior leaders of audit firms. Many of the panelists were among the more than 600 people and organizations that submitted comment letters on the Concept Release. More than 90% of those letters opposed mandatory audit firm rotation.

Most roundtable panelists representing issuers, audit committees and audit firms opposed mandatory audit firm rotation. They pointed to the lack of evidence linking audit firm tenure to possible weaknesses in auditor independence, objectivity or professional skepticism. They also expressed concerns about the increased cost of the audit, including the human capital and audit committee time that would be required to bring a new audit firm up to speed to perform a high-quality audit.

Panelists expressed significant support for retaining audit committee oversight of the

Over 90% of responses to the PCAOB's concept release on enhancing auditor independence, objectivity and professional skepticism oppose mandatory audit firm rotation.

independent auditor, with many panelists stating that the audit committee is well-positioned to identify and engage an auditor that best meets the needs of the company. Several participants noted that alternative ideas could enhance auditor independence, objectivity and skepticism, and that these ideas would be more constructive than the Concept Release's mandatory rotation requirement. The PCAOB staff is analyzing the comments and feedback from the public meetings.

In addition, the PCAOB is reviewing comments on its proposal to enhance the relevance and quality of communications between the auditor and the audit committee. In response to constituents' concerns about its initial March 2010 proposal, the PCAOB tried to better align new communication requirements in the revised proposal with other PCAOB standards. The proposal would not impose additional performance requirements other than communications.

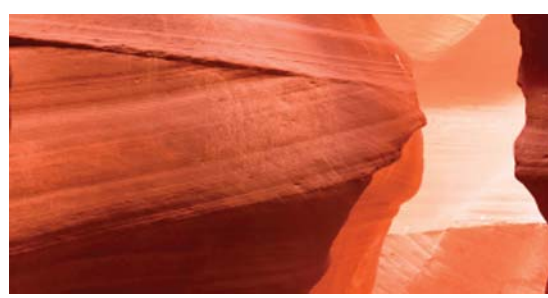
Accounting changes

Audit committee members should keep an eye on potential changes to the company's accounting policies from the joint projects of the Financial Accounting Standards Board and the International Accounting Standards Board (the Boards) on revenue recognition and leases.

Revenue recognition

Commenters on the joint revenue recognition proposal generally agree that the Boards have made significant progress on their proposal to replace essentially all existing revenue guidance in US GAAP and IFRS. However, respondents also say that the proposal needs more implementation guidance to prevent diversity in practice.

In particular, respondents want more clarity on accounting for variable consideration and determining when it is appropriate to recognize revenue over time rather than at a point in time.



This publication and other Ernst & Young audit committee resources are available online at www.ey.com/auditcommittee.

They also expressed concern that the costs of complying with the proposed disclosure requirements would outweigh the benefits, and the disclosures could result in information overload. In addition, many believe retrospective adoption would be too burdensome. We expect the Boards to redeliberate certain aspects of the proposal before issuing a final standard.

Recognizing leases on the balance sheet

The Boards remain committed to recognizing leases on the balance sheet but continue to struggle with how to account for related lease revenue and expense. They are now considering ways to mitigate the front-loading of lease expense for certain leases, and they have agreed to perform additional outreach and research. The Boards also continue to look at the lessor model, which they hope to keep consistent with lessee accounting. The extra work will push back the issuance of an exposure draft until at least the third quarter of 2012. ■

Questions for the audit committee to consider

- What are the audit committee's procedures to monitor auditor independence and audit quality in the current environment?
- How would the PCAOB's auditor communication proposals affect the information that the audit committee currently receives from the independent auditors?
- Does the audit committee understand the potential changes to the company's financial reporting expected to result from the Boards' joint projects (e.g., revenue recognition, leases)?

Effectiveness and accountability in the boardroom

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9–12 December 2012

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