Tab 11: Committee Briefs

Finance & Audit Committee Meeting

ERCOT Public

November 12, 2012

Committee Education

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Finance & Audit Committee Meeting

ERCOT Public

November 12, 2012

Association of Audit Committee Members, Inc.
Center for Audit Quality
Corporate Board Member/NYSE Euronext
Independent Directors Council
Mutual Fund Directors Forum
National Association of Corporate Directors
Tapestry Networks

OCTOBER 2012

Audit Committee Annual Evaluation of the External Auditor

INTRODUCTION

Audit committees of public companies and registered investment companies have direct responsibility to oversee the integrity of a company's financial statements and to hire, compensate and oversee the external auditor. Public focus on how audit committees discharge their responsibilities, including their oversight of the external auditor, has increased significantly.

Each year, audit committees should evaluate the external auditor in fulfilling their duty to make an informed recommendation to the Board whether to retain the auditor. The evaluation should encompass an assessment of the qualifications and performance of the auditor; the quality and candor of the auditor's communications with the audit committee and the company; and the auditor's independence, objectivity and professional skepticism.

To this end, this assessment questionnaire can be used by audit committees to inform their evaluation of the auditor (i.e., the audit firm, as well as the lead audit engagement partner, audit team, and engagement quality reviewer). **The sample questions highlight some of the more important areas for consideration and are not intended to cover all areas that might be relevant to a particular audit committee's evaluation of its auditor or suggest a "one size fits all" approach.** Moreover, this assessment tool is not meant to provide a summary of legal or regulatory requirements for audit committees or auditors. Sources of additional information on hiring and evaluating the auditor and an overview of portions of the relevant standards on required auditor communications with the audit committee are included at the end of this assessment.

ASSESSMENT PROCESS

The annual auditor assessment should draw upon the audit committee's experience with the auditor during the current engagement (presentations; reports; dialogue during formal, ad hoc and executive sessions), informed by prior year evaluations. It is appropriate to obtain observations on the auditor from others within the company, including management and internal audit, accompanied by discussions with key managers. A suggested survey for obtaining observations from others within the company follows the assessment questionnaire. In assessing information obtained from management, the audit committee should be sensitive to the need for the auditor to be objective and skeptical while still maintaining an effective and open relationship. Accordingly, audit committees should be alert to both a strong preference for and a strong opposition to the auditor by management and follow up as appropriate.

It makes good sense for audit committee members to continuously evaluate the auditor's performance throughout the audit process, for example, noting the auditor's skepticism in evaluating unusual transactions or responsiveness to issues. These contemporaneous assessments provide important input into the annual assessment. Audit committees may wish to consider those contemporaneous observations during a more formal assessment process, perhaps by using a questionnaire or guide that considers all relevant factors year-over-year. To ensure that all views are considered, audit committees may wish to finalize their assessment during group discussions (as opposed to collecting audit committee member comments separately) during formal committee meetings or conference calls.

Finally, audit committees should consider advising shareholders that they perform an annual evaluation of the auditor and explain their process and scope of the assessment.

QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE AUDITOR

The audit committee's evaluation of the auditor begins with an examination of the quality of the services provided by the engagement team during the audit and throughout the financial reporting year. Because audit quality largely depends on the individuals who conduct the audit, the audit committee should assess whether the primary members of the audit engagement team demonstrated the skills and experience necessary to address the company's areas of greatest financial reporting risk and had access to appropriate specialists and/or national office resources during the audit. The engagement team should have provided a sound risk assessment at the outset of the audit, including an assessment of fraud risk. During the engagement, the auditor should have demonstrated a good understanding of the company's business, industry, and the impact of the economic environment on the company. Moreover, the auditor should have identified and responded to any auditing and accounting issues that arose from changes in the company or its industry, or changes in applicable accounting and auditing requirements. Another consideration for the audit committee is the quality of the engagement teams that perform portions of the audit in various domestic locations, or abroad by the firm's global network or other audit firms.

SAMPLE QUESTIONS

Q1	Did the lead engagement partner and audit team have the necessary knowledge and skills (company-specific, industry, accounting, auditing) to meet the company's audit requirements? Were the right resources dedicated to the audit? Did the auditor seek feedback on the quality of the services provided? How did the auditor respond to feedback? Was the lead engagement partner accessible to the audit committee and company management? Did he/she devote sufficient attention and leadership to the audit?
Q2	Did the lead engagement partner discuss the audit plan and how it addressed company/industry-specific areas of accounting and audit risk (including fraud risk) with the audit committee? Did the lead engagement partner identify the appropriate risks in planning the audit? Did the lead engagement partner discuss any risks of fraud in the financial statement that were factored into the audit plan?
Q3	If portions of the audit were performed by other teams in various domestic locations, or abroad by the firm's global network or other audit firms, did the lead engagement partner provide information about the technical skills, experience and professional objectivity of those auditors? Did the lead engagement partner explain how he/she exercises quality control over those auditors?
Q4	During the audit, did the auditor meet the agreed upon performance criteria, such as the engagement letter and audit scope? Did the auditor adjust the audit plan to respond to changing risks and circumstances? Did the audit committee understand the changes and agree that they were appropriate?
Q5	Did the lead engagement partner advise the audit committee of the results of consultations with the firm's national professional practice office or other technical resources on accounting or auditing matters? Were such consultations executed in a timely and transparent manner?

QUALITY OF SERVICES AND SUFFICIENCY OF RESOURCES PROVIDED BY THE AUDITOR *continued*

A broader but important consideration is whether the audit firm has the relevant industry expertise, as well as the geographical reach necessary to continue to serve the company, and whether the engagement team effectively utilizes those resources. Other firm-wide questions include the results of the audit firm's most recent inspection report by the Public Company Accounting Oversight Board (PCAOB), including whether the company's audit had been inspected and, if so, whether the PCAOB made comments on the quality or results of the audit. The audit committee also may want to know how the firm plans to respond to PCAOB comments contained in the inspection report, more generally, and to any internal findings regarding its quality control program.

SAMPLE QUESTIONS

Q6	If the company's audit was subject to inspection by the PCAOB or other regulators, did the auditor advise the audit committee of the selection of the audit, findings, and the impact, if any, on the audit results in a timely manner? Did the auditor communicate the results of the firm's inspection more generally, such as findings regarding companies in similar industries with similar accounting/audit issues that may be pertinent to the company? Did the auditor explain how the firm planned to respond to the inspection findings and to internal findings regarding its quality control program?
Q7	Was the cost of the audit reasonable and sufficient for the size, complexity and risks of the company? Were the reasons for any changes to cost (e.g., change in scope of work) communicated to the audit committee? Did the audit committee agree with the reasons?
Q8	Does the audit firm have the necessary industry experience, specialized expertise in the company's critical accounting policies, and geographical reach required to continue to serve the company?
Q9	Did the audit engagement team have sufficient access to specialized expertise during the audit? Were additional resources dedicated to the audit as necessary to complete work in a timely manner?

COMMUNICATION AND INTERACTION WITH THE AUDITOR

Frequent and open communication between the audit committee and the auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the company's financial reporting processes. The quality of communications also provides opportunities to assess the auditor's performance. While the auditor should communicate with the audit committee as significant issues arise, the auditor ordinarily should meet with the audit committee on a frequent enough basis to ensure the audit committee has a complete understanding of the stages of the audit cycle (e.g., planning, completion of final procedures, and, if applicable, completion of interim procedures). Such communications should focus on the key accounting or auditing issues that, in the auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, as well as any questions or concerns of the audit committee.

PCAOB standards, SEC rules, and exchange listing requirements identify a number of matters the auditor must discuss with the audit committee. Audit committees should be familiar with those requirements and consider not only whether the auditor made all of the required communications, but, importantly, the level of openness and quality of these communications, whether held with management present or in executive session.

SAMPLE QUESTIONS

Q10	Did the audit engagement partner maintain a professional and open dialogue with the audit committee and audit committee chair? Were discussions frank and complete? Was the audit engagement partner able to explain accounting and auditing issues in an understandable manner?
Q11	Did the auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments? Did the auditor discuss how the company's accounting policies compare with industry trends and leading practices?
Q12	In executive sessions, did the auditor discuss sensitive issues candidly and professionally (e.g., his/her views on, including any concerns about, management's reporting processes; internal control over financial reporting (e.g., internal whistle blower policy); the quality of the company's financial management team)? Did the audit engagement partner promptly alert the audit committee if he/she did not receive sufficient cooperation?
Q13	Did the auditor ensure that the audit committee was informed of current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential impact on the audit?

AUDITOR INDEPENDENCE, OBJECTIVITY AND PROFESSIONAL SKEPTICISM

The auditor must be independent of the issuer and — in the case of mutual funds, independent of the investment company complex. Audit committees should be familiar with the statutory and regulatory independence requirements for auditors, including requirements that the auditor advise the audit committee of any services or relationships that reasonably can be thought to bear on the firm's independence.

The technical competence of the auditor alone is not sufficient to ensure a high-quality audit. The auditor also must exercise a high level of objectivity and professional skepticism. The audit committee's interactions with the auditor during the audit provide a number of opportunities to evaluate whether the auditor demonstrated integrity, objectivity and professional skepticism. For example, the use of estimates and judgments in the financial statements and related disclosures (e.g., fair value, impairment) continues to be an important component of financial reporting. The auditor must be able to evaluate the methods and assumptions used and challenge, where necessary, management's assumptions and application of accounting policies, including the completeness and transparency of the related disclosures.

An important part of evaluating the auditor's objectivity and professional skepticism is for the audit committee to gauge the frankness and informative nature of responses to open-ended questions put to the lead audit engagement partner (and members of the audit engagement team as appropriate). Examples of appropriate topics include: the financial reporting challenges posed by the company's business model; the quality of the financial management team; the robustness of the internal control environment; changes in accounting methods or key assumptions underlying critical estimates; and the range of accounting issues discussed with management during the audit (including alternative accounting treatments and the treatment preferred by the auditor). The auditor also should be able to clearly articulate the processes followed and summarize the evidence used to evaluate the significant estimates and judgments, and to form an opinion whether the financial statements, taken as a whole, were fairly presented in accordance with Generally Accepted Accounting Principles.

SAMPLE QUESTIONS

Q14	Did the audit firm report to the audit committee all matters that might reasonably be thought to bear on the firm's independence, including exceptions to its compliance with independence requirements? Did the audit firm discuss safeguards in place to detect independence issues?
Q15	Were there any significant differences in views between management and the auditor? If so, did the auditor present a clear point of view on accounting issues where management's initial perspective differed? Was the process of reconciling views achieved in a timely and professional manner?
Q16	If the auditor is placing reliance on management and internal audit testing, did the audit committee agree with the extent of such reliance? Were there any significant differences in views between the internal auditors and the auditor? If so, were they resolved in a professional manner?
Q17	In obtaining pre-approval from the audit committee for all non-audit services, did the lead engagement partner discuss safeguards in place to protect the independence, objectivity and professional skepticism of the auditor?

EXAMPLE FORM
OBTAINING INPUT ON THE EXTERNAL AUDITOR FROM COMPANY PERSONNEL

Because you have substantial contact with the external auditors throughout the year, the Audit Committee is interested in your views on the quality of service provided, and the independence, objectivity, and professional skepticism demonstrated throughout the engagement by the external audit team and firm.

Please rate the auditor's performance on each of the following attributes using a five-point scale, where 5 = Very High/ Completely Satisfied and 1 = Very Low/Completely Dissatisfied.

	QUALITY OF SERVICES PROVIDED BY THE EXTERNAL AUDITOR	RATING
1	**Meets commitments** e.g., by meeting agreed upon performance delivery dates, being available and accessible to management and the audit committee.	
2	**Is responsive and communicative** e.g., by soliciting input relative to business risks or issues that might impact the audit plan, identifying and resolving issues in a timely fashion, and adapting to changing risks quickly.	
3	**Proactively identifies opportunities and risks** e.g., by anticipating and providing insights and approaches for potential business issues, bringing appropriate expertise to bear, and by identifying meaningful alternatives and discussing their impacts.	
4	**Delivers value for money** e.g., by charging fees that fairly reflect the cost of the services provided, and being thoughtful about ways to achieve a cost-effective quality audit.	

	SUFFICIENCY OF AUDIT FIRM RESOURCES	RATING
5	**Is technically competent and able to translate knowledge into practice** e.g., by delivering quality services within the scope of the engagement, using technical knowledge and independent judgment to provide realistic analysis of issues, and providing appropriate levels of competence across the team.	
6	**Understands our business and our industry** e.g., by demonstrating an understanding of our specific business risks, processes, systems and operations, by sharing relevant industry experience, and by providing access to firm experts on industry and technical matters.	
7	**Assigned sufficient resources to complete work in a timely manner** e.g., by providing access to specialized expertise during the audit and assigning additional resources to the audit as necessary to complete work in a timely manner.	

	COMMUNICATION AND INTERACTION	RATING
8	**Communicates effectively** e.g., by maintaining appropriate levels of contact/dialogue throughout the year, effectively communicating verbally and in writing, being constructive and respectful in all interactions, and providing timely and informative communications about accounting and other relevant developments.	
9	**Communicates about matters affecting the firm or its reputation** e.g., by advising us on significant matters pertaining to the firm while respecting the confidentiality of other clients' information, and complying with professional standards and legal requirements, including informing us when the company's audit is subject to inspection by the PCAOB or other regulatory review and sharing the results of the review that are pertinent to the company's accounting or auditing issues.	

	INDEPENDENCE, OBJECTIVITY AND PROFESSIONAL SKEPTICISM	RATING
10	**Demonstrates integrity and objectivity** e.g., by maintaining a respectful but questioning approach throughout the audit, proactively raising important issues to appropriate levels of the organization until resolution is reached, and articulating a point of view on issues.	
11	**Demonstrates independence** e.g., by proactively discussing independence matters and reporting exceptions to its compliance with independence requirements.	
12	**Is forthright in dealing with difficult situations** e.g., by proactively identifying, communicating and resolving technical issues, raising important issues to appropriate levels in the organization, and by handling sensitive issues constructively.	

	RECOMMENDATIONS
13	**Are there actions the external auditor should take to improve its delivery of a quality audit?**

Please sign, date and return the form to ________________________________ by _________.

Questions may be directed to ________________________________. Thank you.

Signed ____ Title____________________________________

Date ____________________

RELEVANT REQUIREMENTS AND STANDARDS

PROHIBITED NON-AUDIT SERVICES

There are nine statutory categories of non-audit services that may not be provided to companies by the external auditors (Section 10A (g) to the Securities Exchange Act of 1934). For investment companies, these non-audit services may not be provided to any company in the investment company complex (as defined in 210.2-01(f)(14)):

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Financial information systems design and implementation;
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services;
- Legal services and expert services unrelated to the audit; and
- Any other service that the PCAOB determines, by regulation, is impermissible.

Audit committees must pre-approve the provision of all other non-audit services by the auditor.

OVERVIEW OF AUDITOR COMMUNICATIONS WITH AUDIT COMMITTEES

SEC Rule 2-07 requires the auditor to communicate the following to the audit committee prior to the filing of the company's Form 10-K. For investment companies that file Form N-CSR, these communications must take place annually, except that if the annual communication takes place more than 90 days prior to the filing, the auditor must provide an update describing any changes to the previously reported information.

- Critical accounting policies and practices used by the issuer;
- Alternative accounting treatments within U.S. GAAP for accounting policies and practices related to material items that have been discussed with management during the current audit period, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the independent auditor;
- Material written communications between the independent auditor and management of the issuer; and
- If the audit client is an investment company, all non-audit services provided to any entity in an investment company complex that were not pre-approved by the investment company's audit committee pursuant to 210.2-01(c)(7).

PCAOB Auditing Standard No. 16 (AS 16), Communications with Audit Committees, replaces AU 380 for audits of issuers for fiscal years ending on or after December 15, 2012.[1] The standard requires the following communication with the audit committee:

- The independent auditor's responsibilities in relation to the audit under the standards of the PCAOB; as part of establishing an understanding with the audit committee on the terms of the engagement; preferably through a written communication (i.e., engagement letter). Also requires communication of major issues discussed with management prior to the initial selection or retention as auditors;
- Whether the audit committee is aware of any matters relevant to the audit, particularly any violations of laws or regulations. Also requires the auditor to communicate the overall audit strategy, timing of the audit and significant risks; including the participation of others in the audit (i.e., specialists, firms beside the principal auditor, etc.); and

[1] Auditors of emerging growth companies and broker dealers are subject to AU 380 until the SEC determines to extend AS 16 to the former and adopts amendments to SEC Rule 17a-5 for the latter.

- The following with respect to the entity's accounting policies and practices, estimates and significant unusual transactions; and the auditor's evaluation of the quality of a company's financial reporting:
  - Significant accounting policies and practices – Management's initial selection of, or changes in the current period; the effect on financial statements or disclosures for policies that are considered controversial, there is a lack of guidance, or diversity in practice; and the auditor's qualitative assessment of such policies and practices. Specifically, the quality, not just the acceptability, of the company's accounting principles as applied in its financial reporting and disclosures, including situations in which the auditor identified bias in management's judgments and the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements which are individually reasonable, that indicate a possible bias on the part of company management;
  - Critical accounting policies and practices – The reasons such policies and practices are considered critical; how current and anticipated events could affect this determination; and the auditor's assessment of related management disclosures;
  - Critical accounting estimates – A description of the process used to develop such estimates; management's significant assumptions in the estimates that have a high degree of subjectivity; any significant changes in management's process to develop an estimate; and the auditor's conclusion as to the reasonableness of such estimates;
  - Significant unusual transactions – Significant transactions outside the normal course of business, or that are unusual due to timing, size or nature; and the auditor's understanding for the business rationale of such transactions;
  - Financial statement presentation – The evaluation of whether the financial statements and related disclosures are presented fairly in accordance with the applicable financial reporting framework;
  - New accounting pronouncements – Any concern identified by the auditor related to management's application of pronouncements that have been issued but are not yet effective in relation to future periods; and
  - Alternative accounting treatments – All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.

- Other communications from the auditor include:
  - Other information – The auditor's responsibility with respect to and results of audit procedures performed on other information accompanying the audited financial statements;
  - Difficult or contentious matters for which the auditor consulted;
  - Management consultation with other accountants;
  - Going concern – Whether the auditor believes there is: i) substantial doubt including related events or conditions; ii) substantial doubt has been alleviated due to management's plan; iii) substantial doubt remains despite management's plans; and iv) related effect on the financial statements;
  - Corrected and uncorrected misstatements and omitted disclosures – Requires the auditor to provide the audit committee with a written schedule of uncorrected misstatements that was provided to management. Also requires communication for the basis of whether: i) uncorrected misstatements were immaterial, including qualitative assessment; ii) uncorrected misstatements or underlying matters could potentially cause future-period financial statements to be materially misstated; and iii) corrected misstatements other than those deemed trivial, that might not have been detected other than through the audit procedures;
  - Disagreements with management, whether or not satisfactorily resolved that individually or in the aggregate could be significant to the entity's financial statements or the audit report; and
  - Significant difficulties encountered with management in performing the audit.

PCAOB standards require the independent auditor to communicate all material weaknesses and significant deficiencies identified during the audit to the audit committee. If the independent auditor concludes that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, the auditor is required to inform the board of directors.

PCAOB rules also require at least an annual written statement delineating all relationships between the independent auditor and the company, including individuals in financial reporting oversight roles at the company that reasonably can be thought to bear on independence.

New York Stock Exchange Rule 303A.07(b), from its Listed Company Manual, requires audit committees to have a written charter that sets forth the committee's purpose, including, at a minimum, certain provisions of SEC rule 10A-3(b) (2), (3), (4), and (5), as well as other specific duties and responsibilities, to assist board oversight of the integrity of the company's financial statements, and the independent auditor's qualifications, independence and performance. Pertinent to auditor oversight, the rule includes the following audit committee requirements:

- Obtain and review at least annually a report by the independent auditor which describes the firm's internal quality-control procedures; 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 any such issues; and (to assess the auditor's independence) all relationships between the independent auditor and the listed company;
- Meet to review and discuss the listed company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the listed company's i) specific disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations"; and ii) policies with respect to risk assessment and risk management, the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies;
- Meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors;
- Review with the independent auditor any audit problems or difficulties and management's response;
- Set clear hiring policies for employees or former employees of the independent auditors; and
- Report regularly to the board of directors.

Commentary to the rule pertinent to the assessment of the independent auditor further provides that after reviewing the auditor's quality control report and the auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance and independence (including a review and evaluation of the lead partner) taking into account the opinions of management and the company's internal auditors. The commentary further provides that, in addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. Finally, audit committees are instructed to present their conclusions to the full board of directors.

RECENT SOURCES AND SUGGESTED READINGS

New York Stock Exchange. *New York Stock Exchange Listed Company Manual.* 2012.

Public Company Accounting Oversight Board. *Information for Audit Committees about the PCAOB's Inspection Process.* August 2012.

KPMG Audit Committee Institute. "Is Governance Keeping Pace?" *2012 Audit Committee Issues Conference Highlights.* March 2012.

The Institute of Chartered Accountants in Australia, the Financial Reporting Council, and The Institute of Chartered Accountants of Scotland. *Walk the line: Discussions and insights with leading audit committee members.* February 2012.

Deloitte & Touche LLP. *Audit Committee Resource Guide*. December 2011.

PwC LLP. *Audit Committee Effectiveness: What Works Best, 4th Edition.* Catherine L. Bromilow and Donald P. Keller. June 2011.

National Association of Corporate Directors and the Center for Board Leadership, KPMG LLP and Alliance Partners. *Report of the NACD Blue Ribbon Commission on Audit Committees.* October 2010.

PwC LLP. *Working Guide for an Investment Company's Audit Committee.* 2010.

Accounting and Corporate Regulatory Authority and Singapore Exchange Limited. *Guidance to Audit Committees on Evaluation of Quality of Work Performed by External Auditors.* July 2010.

Grant Thornton LLP. *The Audit Committee Handbook, Fifth Edition.* Louis Braiotta, Jr., R. Trent Gazzaway, Robert H. Colson and Sridhar Ramamoorthi. April 2010.

BDO USA LLP. *Effective Audit Committees in the Ever Changing Marketplace.* 2010.

Ernst & Young LLP. *Audit Committee Member Toolkit.* June 2009.

September 2012

Financial reporting briefs

What you need to know about this quarter's accounting, financial reporting and other developments

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Ernst & Young
Quality In Everything We Do

Accounting update

Welcome to the September 2012 *Financial reporting briefs*.

This edition provides highlights of the SEC staff's Final Report on IFRS. It also brings you up to speed on the latest developments on the joint projects of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards).

The regulatory developments section summarizes the various initiatives of the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB).

In other considerations, we shed light on the FASB's private company framework project and the status of certain other projects.

The reference library lists our recent publications that provide additional details on the items discussed in this edition.

Final Report on IFRS issued, but no final decision likely before next year

In its Final Report on its Work Plan related to a possible move to a set of global accounting standards, the SEC staff summarized what it has learned. The Commission will use the Final Report, along with other information, to decide whether and, if so, how and when to incorporate IFRS into the financial reporting system for US issuers. The staff noted that the Final Report does not indicate that the SEC has made a policy decision about whether to incorporate IFRS into the US financial reporting system.

The staff said a large majority of constituents opposed a requirement to adopt the standards of the IASB outright and noted that many countries that have incorporated IFRS into their financial reporting systems did not use this method. However, the staff indicated that many of the issues identified by the staff and other constituents would appear to be at least partly mitigated by an endorsement approach that retains a role for the FASB in the standard-setting process and incorporates IFRS into US GAAP.

The Commission said that more analysis is required before it makes a final decision on whether and, if so, how and when to incorporate IFRS into the US financial reporting system. As a result, we do not expect the Commission to make a decision this year.

Items to consider as you prepare for annual impairment testing

Companies now have the option under Accounting Standards Update (ASU) 2012-02[1] to perform a qualitative impairment assessment for their indefinite-lived intangible assets that may allow them to skip the annual fair value calculation. The qualitative assessment is similar to the screen companies can use to determine whether they must perform the two-step goodwill impairment test. To perform a qualitative assessment on an indefinite-lived intangible asset, a company must identify and evaluate changes in economic, industry and company-specific events and circumstances that could affect the significant inputs used in determining the fair value of that asset. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012. Early adoption is permitted.

Companies that are thinking about using a qualitative assessment to test goodwill or indefinite-lived intangible assets for impairment will need to apply significant judgment. Issues companies should consider include the results of their most recent quantitative impairment tests as well as recent trends in the macro-economic environment and in their industry. Companies should focus on events and circumstances that may affect the significant inputs to fair value (e.g., projected cash flows, discount rates, market multiples or other inputs). Developing clear, contemporaneous documentation will help a company support its assertion that the fair value is not less than the carrying amount.

[1] ASU 2012-02, *Testing Indefinite-Lived Assets for Impairment (ASC 350).*

A return to straight-line expensing for some leases, with a twist

The FASB and the IASB have again changed direction on how lease expense would be recognized, as part of their redeliberations on the leases joint project. Similar to current practice, under the proposed model, lease expense would be recognized on a straight-line basis for some leases and on an accelerated basis for others. Lessees, however, would recognize all leases, other than short-term leases, on the balance sheet.

The principle for classifying leases (i.e., deciding which approach to apply) would be based on whether the lessee acquires and consumes more than an insignificant portion of the underlying asset over the lease term. The Boards simplified the classification assessment by including a practical expedient that leases would be classified based primarily on the nature of the underlying asset being leased. Therefore, unless certain conditions are met, leases of property (i.e., land, building or part of a building) would have a straight-line expense recognition pattern and leases of assets other than property (e.g., equipment) would have an accelerated expense recognition pattern.

Lessors would apply the same classification criteria as lessees, although their balance sheet treatment would differ. No special provisions would be included for lessors of investment property.

The Boards expect to issue a new exposure draft for comment in the fourth quarter of 2012.

Boards ditch onerous performance obligations in redeliberations on revenue

In redeliberations on their most recent joint revenue recognition proposal, the Boards tentatively decided to remove the proposed requirement to measure and recognize losses on onerous performance obligations in customer contracts. Instead, the Boards tentatively decided to look to existing guidance, even though this would mean that existing differences between US GAAP and IFRS in this area would remain.

The Boards are redeliberating more than 40 topics, including whether consideration received for the sale of a license should be recognized over time or at a point in time. The Boards asked their staffs to perform additional analysis to help them reach a final decision on this topic.

While much is left to discuss, the Boards still plan to issue a final standard in the first half of 2013.

The big picture on the classification and measurement of financial instruments

A new model is emerging from the FASB's redeliberations of its original classification and measurement proposal. Financial assets generally would still be classified and measured in one of three categories: fair value through net income (FV-NI), fair value through other comprehensive income or amortized cost. However, in contrast to current US GAAP, the measurement category now would be determined first by the cash flow characteristics of the asset (i.e., whether cash flows are solely principal and interest) and then by evaluating the entity's business model for managing the asset (i.e., its plans for holding or selling the asset).

Financial assets that do not meet the cash flow characteristics assessment (e.g., equity securities) would be measured at FV-NI. However, as an exception to this general principle, entities would be allowed to measure nonmarketable equity securities at cost. Separately, financial assets that meet the cash flow characteristics assessment (e.g., debt instruments) would be classified and measured under one of the three measurement categories, as determined by management's business model.

Under the new model, financial liabilities generally would be recorded at amortized cost, with certain exceptions. An unconditional fair value option would not be provided for financial assets or financial liabilities, although they may be eligible for a conditional fair value option in certain limited circumstances.

The FASB expects to issue a revised proposal for classification and measurement in 2012.

FASB exploring a single measurement approach for financial asset impairment

In response to concerns raised by constituents about the understandability, operability and auditability of the jointly deliberated three-bucket impairment model, the FASB is developing an alternative, single measurement approach for impairment of financial assets. The "current expected credit loss model" would retain certain key concepts from the jointly deliberated model, including the concept of expected credit losses. However, the new model would eliminate the use of three buckets and the determination of when to transfer assets between those buckets. Additionally, loss estimates would not be limited to those expected over a specified period of time.

The FASB expects to issue an exposure draft on the single measurement approach before the end of 2012. It is unclear whether the IASB will pursue a similar approach and therefore the FASB's decisions may diverge from those of the IASB.

Trends in the adoption of the new fair value disclosures

We analyzed how a sample of public companies initially adopted the new disclosures required by ASU 2011-04[2] in their 31 March 2012 quarter filings. Not surprisingly, we found differences in the way companies complied with the requirements in a number of areas, including the types of quantitative information companies disclosed about the significant unobservable inputs (e.g., the range of inputs used, the weighted average inputs for an asset class) used in their Level 3 measurements and the level of disaggregation at which they provided the information. The disclosures were more consistent in other areas, though, including how companies addressed pricing information from third-party vendors (e.g., pricing services, brokers).

These new disclosures may evolve over time as companies refine the information they provide based on leading practices that emerge and feedback received from the SEC staff. In fact, we have noted that the SEC staff has already begun questioning registrants about how they complied with the new disclosure requirements.

[2] ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.*

The EITF remains busy with a number of issues

The FASB issued the following Proposed ASUs from the Emerging Issues Task Force (EITF) for comment by 20 September 2012:

- *Not-for-Profit Entities: Personnel Services Received from an Affiliate for Which the Affiliate Does Not Seek Compensation (EITF Issue12-B)*
- *Accounting for Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (EITF Issue12-D)*

The comment period on the following Proposed ASUs ended in July, and the EITF and FASB are considering the feedback received:

- *Not-for-Profit Entities: Classification of the Sale of Donated Securities in the Statement of Cash Flows (EITF Issue12-A)*
- *Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution (EITF Issue12-C)*
- *Accounting for Fair Value Information That Arises after the Measurement Date and Its Inclusion in the Impairment Analysis of Unamortized Film Costs (EITF Issue12-E)*

The remaining issues on the EITF's agenda will be discussed in the near future:

- *Parent's Accounting for the Cumulative Translation Adjustment upon the Loss of a Controlling Financial Interest in a Subsidiary or Group of Assets That Is a Nonprofit Activity or a Business within a Consolidated Foreign Entity (EITF Issue11-A)*
- *Recognition of New Accounting Basis (Pushdown) in Certain Circumstances (EITF Issue12-F)*
- *Accounting for the Excess in the Fair Value of Assets over Liabilities of a Consolidated Collateralized Financing Entity (EITF Issue12-G)*

A variety of stakeholders have expressed interest in EITF Issue12-F because it could affect the accounting for many transactions. To assist the EITF, the FASB chairman directed the FASB staff to form a working group to discuss the scope of the issue. The EITF has not yet reached a decision on the scope of the project.

Liquidity and interest rate risk proposal would greatly expand disclosures

The FASB proposal would require all entities to significantly expand their disclosures about risks inherent in financial instruments. All public, private and not-for-profit entities would be required to provide certain disclosures about liquidity risks and uncertainties they might encounter in meeting their financial obligations. Entities also will need to consider whether they or any of their reportable segments are financial institutions, as defined in the proposal, because financial institutions would be required to provide additional disclosures about their exposure to interest rate risks. Comments are due by 25 September 2012.

FASB proposes presenting reclassifications out of AOCI in one place

The FASB proposed requiring companies to provide new tabular disclosures about items reclassified out of accumulated other comprehensive income (AOCI). For items reclassified to net income in their entirety (e.g., gains on available-for-sale securities), the disclosures would include the amount reclassified and would identify the line item affected by the reclassification on the statement where net income is presented. For other AOCI reclassification items not required to be reclassified directly to net income in their entirety (e.g., pension-related items that are capitalized in inventory), the table would list cross-references to other disclosures where additional details about their effects are disclosed.

The proposal is the FASB's response to concerns that companies raised about presenting reclassification adjustments for each component of AOCI in both net income and other comprehensive income on the face of the financial statements.

Comments on the proposal are due by 15 October 2012. The FASB also discussed and is seeking input on whether to require these disclosures this year-end for calendar-year public companies.[3]

FASB continues ironing out wrinkles in its investment company project

The FASB has moved away from the strict criteria approach for defining an investment company, which was included in its exposure draft. Instead, an entity would have to meet certain criteria and assess other typical characteristics of an investment company. The FASB still needs to discuss some topics before completing this project and issuing a final standard by the end of the year. The IASB also plans to finalize its similar "investment entity" standard by the end of the year.

FASB thinking about how to improve disclosure requirements

The FASB is seeking comment on a discussion paper on a framework for improving the effectiveness of disclosures in the notes to the financial statements. The paper is not a proposal, but rather a means to gather stakeholder input as the FASB develops a possible proposal. The FASB's goal is to improve the effectiveness of disclosures by clearly communicating the information that is most important to the users of a company's financial statements. To achieve this goal, the FASB believes it must develop a framework that promotes consistent decisions about disclosure requirements and helps companies determine relevant disclosures.

The discussion paper asks for input on a number of issues, including:

- A decision process that could help the FASB establish disclosure requirements
- A way to make flexible disclosure requirements so that each company could tailor its disclosures to meet the needs of its financial statement users

[3] The FASB is seeking input on the possibility of making the proposal effective for public companies for annual reporting periods ending after 15 December 2012 and interim and annual periods thereafter. It may be delayed one year for private companies.

- A judgment framework to help companies tailor their disclosures
- Organization and formatting techniques that would make information easier to find and understand
- A framework for evaluating disclosure requirements for interim period financial statements

Comments on the discussion paper are due by 16 November 2012.

Discussion paper issued on private company framework

Preparers and users of private company financial statements should pay close attention to the FASB staff's discussion paper on a private company decision-making framework. The framework's objective is to identify and address how the needs of users of private company financial statements differ from those of users of public company financial statements, and to find opportunities to reduce the cost and complexity of providing information to those users. While the framework is not intended to lead to a fundamentally different basis for preparing financial statements of private companies, it would be used to identify whether and when exceptions or modifications to US GAAP are appropriate for private company financial reporting.

In the paper, the staff identifies what it believes are key differences in the financial reporting considerations of private and public companies and comments on the implications of those differences. The paper also highlights criteria that would be considered in determining whether and when to adjust recognition, measurement, disclosure, display, effective date, or transition requirements for private companies. Comments are due by 31 October 2012.

Lessons learned from reviewing restatements

Errors in accounting for income taxes, revenue recognition and the preparation of the statement of cash flows were the leading causes of restatements of annual financial statements in 2011.[4] Understanding the topics that gave rise to restatements can help companies as they perform internal risk assessments and evaluate their control environments. Asking questions about the more frequent restatement topics also could be helpful to management and audit committee members. Our Technical Line publication *Lessons learned from our review of restatements* summarizes recent restatement trends and analyzes the accounting topics that gave rise to restatements. The publication also includes a list of questions for management or audit committee members to consider about some of the more frequent restatement topics.

Liquidation accounting would be required when liquidation is imminent

Under the FASB's proposal, entities would be required to prepare financial statements on a liquidation basis when management stops making significant decisions about furthering the operations of an entity or limits its decisions to those necessary to carry out a liquidation plan. A limited-life entity would not prepare financial statements using the liquidation basis of accounting if it carries out the liquidation plan specified in its governing documents. Comments are due by 1 October 2012.

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[4] Statistics were derived from our review of restatements of US public companies that are audited by the four largest accounting firms, as disclosed in annual financial statements filed during the year ended 31 December 2011.

Regulatory developments

In this section, we highlight the latest initiatives of the SEC and the PCAOB, including the SEC's new rule for conflict mineral reporting that could have a significant effect on many companies.

Final conflict minerals rule requires new reporting for many companies

The SEC approved its final rule requiring issuers to disclose the use of conflict minerals[5] in their products and whether those minerals originated from the Democratic Republic of the Congo and neighboring countries (i.e., covered countries). The rule was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act in response to humanitarian concerns that trade in conflict minerals is financing armed groups in the region.

The rule requires an issuer to determine whether conflict minerals are necessary to products it manufactures or contracts to be manufactured. If so, the issuer must make a "reasonable country of origin inquiry" into whether its conflict minerals come from covered countries. The issuer would be required to perform due diligence procedures to determine whether any conflict minerals obtained from covered countries are "conflict free" and file a Conflict Minerals Report as an exhibit to its specialized disclosure report filed annually with the SEC on the new Form SD.

While the scope of the final rule is narrower than the original proposal, the rule still may affect 6,000 or more companies. Initial reports must be filed by 31 May 2014 (covering calendar year 2013).

PCAOB continues to seek feedback on auditor independence

The PCAOB held another roundtable on its concept release on auditor independence and mandatory firm rotation and briefly reopened the comment period. Consistent with feedback from other outreach efforts, participants generally supported improving audit quality and enhancing auditor independence, but were generally against mandatory audit firm rotation. The PCAOB will continue gathering feedback through additional outreach, which will likely extend this project into 2013.

New rules focus on compensation committees and their use of advisers

The SEC finalized a rule that will require national securities exchanges to adopt minimum listing standards related to compensation committees and their use of advisers. Under these standards, a member of a listed company's compensation committee must be an "independent" member of the board of directors, as defined by the exchange. Listing standards must require that compensation committees have the authority to retain advisers and be responsible for their appointment, payment and oversight.

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[5] Conflict minerals are defined as cassiterite, columbite-tantalite, gold and wolframite or their derivatives (limited to tin, tantalum and tungsten), and other minerals or derivatives that the US Secretary of State names in the future. These minerals are used in mobile telephones, computers, video game consoles, digital cameras, jet engine components, jewelry, electronic equipment and electrical, heating and welding applications.

The SEC also amended proxy rules to require companies to disclose in their proxy statements whether the work of compensation advisers raised any conflicts of interest. If so, companies will have to describe the conflict and explain how the conflict was addressed. While the rule does not define a conflict of interest, the SEC notes that a company should, at a minimum, consider the six independence factors required to be considered when selecting an adviser. The new disclosure requirements go into effect for shareholder meetings on or after 1 January 2013.

Proposal would allow investor solicitations in certain exempt offerings

Companies would be permitted to solicit investors and advertise certain exempt offerings of securities, under a proposed rule from the SEC. The rule was mandated by the Jumpstart Our Businesses Startups Act (JOBS Act) and is intended to make it easier for companies to raise capital. Many companies and investors could benefit. The proposal would affect offerings under Rule 144A, which governs the resale of restricted securities to qualified institutional buyers (QIBs). Sellers of restricted securities under Rule 144A could solicit investors and advertise the offerings as long as they and anyone acting on their behalf reasonably believe the purchasers are QIBs. Many private companies making initial securities offerings under Rule 506 of Regulation D also would get similar relief in transactions with accredited investors. The proposed rule will be published in the Federal Register soon and comments are due 30 days after publication.

PCAOB tries to demystify the inspection process

In response to feedback from public company audit committees, the PCAOB issued a release to help audit committees understand its inspections of registered public accounting firms and gather useful information about those inspections from independent auditors. Among other things, the release includes a number of questions related to the inspection process that the PCAOB encourages audit committees to consider asking their auditors.

Communications between auditors and audit committees will change

The PCAOB adopted Auditing Standard No. 16,[6] which establishes requirements designed to enhance the relevance and quality of communications between the auditor and the audit committee. The standard does not impose any additional performance requirements other than certain communications. The standard and related amendments, if approved by the SEC, will be effective for auditors of public companies with fiscal periods beginning after 15 December 2012.

[6] Auditing Standard No. 16, *Communications with Audit Committees.*

Public companies must disclose prohibited activities involving Iran

President Barack Obama signed a new Iran sanctions act on 10 August 2012 that, among other things, requires public companies to disclose in their annual and quarterly reports filed with the SEC whether they or their affiliates knowingly engaged in various prohibited activities involving Iran. The new act amends Section 13 of the Exchange Act of 1934 to require public companies to self-report any prohibited activities, including the nature and extent of the activity, gross revenues and net profits attributable to the activity and whether the registrant or any of its affiliates intend to continue engaging in such activities. Disclosures are required in annual and quarterly reports filed with the SEC 180 days after enactment (i.e., on or after 6 February 2013).

2009 US GAAP XBRL Taxonomy phased out

EDGAR no longer accepts XBRL exhibits using the 2009 US GAAP XBRL Taxonomy. Registrants may continue to use the 2011 US GAAP XBRL Taxonomy, but the SEC staff strongly encourages companies to adopt the latest version of the taxonomy for their XBRL exhibits (i.e., the 2012 taxonomy released in March 2012). Details about the taxonomies can be found on the FASB and SEC websites.

Recent changes at the SEC

James Kroeker stepped down from his post as SEC Chief Accountant and left the SEC. Paul Beswick, the former Deputy Chief Accountant, was named acting Chief Accountant until a permanent Chief Accountant is named.

Other considerations

Proposal to change the auditor's report may be coming

The PCAOB expects to issue for public comment a proposal to modify the auditor's reporting model in the near future. The proposal may include many of the items that were in the 2011 concept release on this project.

Executive compensation rules waiting in the wings

The SEC updated its Dodd-Frank agenda to no longer provide estimated time frames for rule-making, including the timing of final rules on executive compensation. The executive compensation rules would require annual proxy statements to disclose pay-to-performance relationships, pay ratios of chief executive officers to other employees and executive compensation clawback policies. As we move closer to year-end, it is unlikely that these rules will be effective for the upcoming 2013 proxy season.

No IPEs, but fair value could still be an option

The FASB tentatively decided not to develop entity-based accounting guidance for investment property entities (IPEs). The FASB plans to consider the results of related standard-setting projects before deciding whether to abandon the investment property project in its entirety or pursue another approach, such as developing asset-based guidance for investment property.

Consolidation project still in the works

The FASB has begun redeliberating its proposal to amend the consolidation guidance to require the decision maker of a variable interest entity or voting partnership to evaluate whether it is acting as a principal or as an agent.

Private company fair value disclosure project discontinued

The FASB recently announced that its project to reduce the fair value disclosure requirements for private companies has been removed from the Board's current agenda. A number of stakeholders indicated the benefits of the proposal would be minimal and suggested that the FASB first consider certain fair value accounting requirements for private companies before addressing disclosures.

FASB ends its loss contingency project

The FASB decided to discontinue its loss contingencies disclosure project, which would have significantly expanded quantitative and qualitative disclosures for all loss contingencies. In voting to discontinue the project, some Board members said that any issue with loss contingency disclosures is a compliance matter, not a standard-setting matter. We expect the SEC staff to continue its focus on compliance in this area.

Summary of open comment periods

The following table summarizes comment periods for the key proposals and discussion papers we highlight in this publication.

Proposal or discussion paper	Comment period ends
Accounting for personnel services (EITF Issue 12-B)	20 September 2012
Joint and several liability (EITF Issue 12-D)	20 September 2012
Liquidity and interest rate risk	25 September 2012
Liquidation basis of accounting	1 October 2012
Presentation of AOCI reclassifications	15 October 2012
Private company framework discussion paper	31 October 2012
Disclosure framework discussion paper	16 November 2012

Effective date highlights

Public companies

Effective in 2012 (for public calendar year-end companies)		Effective beginning (for calendar year-end companies)
ASU 2011-12 — Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASC 220)	Fiscal years (and interim periods within those years) beginning after 15 December 2011	Q1 2012
ASU 2011-08 — Testing Goodwill for Impairment (ASC 350)	Fiscal years beginning after 15 December 2011[1]	Q1 2012
ASU 2011-07 — Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (EITF Issue 09-H; ASC 954)	Fiscal years (and interim periods within those years) beginning after 15 December 2011	Q1 2012
ASU 2011-05 — Presentation of Comprehensive Income (ASC 220)	Fiscal years (and interim periods within those years) beginning after 15 December 2011	Q1 2012
ASU 2011-04 — Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASC 820)	Periods beginning after 15 December 2011	Q1 2012
ASU 2011-03 — Reconsideration of Effective Control for Repurchase Agreements (ASC 860)	Periods beginning on or after 15 December 2011	Q1 2012
ASU 2010-26 — Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (EITF 09-G; ASC 944)	Fiscal years (and interim periods within those years) beginning after 15 December 2011	Q1 2012

Effective after 2012 (for public calendar year-end companies)		Effective beginning (for calendar year-end companies)
ASU 2012-02 — Testing Indefinite-Lived Intangible Assets for Impairment (ASC 350)	Fiscal years beginning after 15 September 2012[2]	Q1 2013
ASU 2012-01 — Continuing Care Retirement Communities — Refundable Advance Fees (ASC 954)	Fiscal periods beginning after 15 December 2012	Q1 2013
ASU 2011-11 — Disclosures about Offsetting Assets and Liabilities (ASC 210)	Annual reporting periods beginning on or after 1 January 2013 (and interim periods within those annual periods)	Q1 2013
ASU 2011-10 — Derecognition of in Substance Real Estate — a Scope Clarification (EITF Issue 10-E; ASC 360)	Fiscal years (and interim periods within those years) beginning on or after 15 June 2012	Q1 2013
ASU 2011-06 — Fees Paid to the Federal Government by Health Insurers (EITF Issue 10-H; ASC 720)	Calendar years beginning after 31 December 2013	Q1 2014

[1] The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after 15 December 2011.

[2] The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012.

Effective date highlights

Private companies

Effective in 2012 (for private calendar year-end companies)	
ASU 2011-12 — Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASC 220)	Fiscal years ending after 15 December 2012 (and interim and annual periods thereafter)
ASU 2011-09 — Disclosures about an Employer's Participation in a Multiemployer Plan (ASC 715-80)	Annual periods for fiscal years ending after 15 December 2012
ASU 2011-08 — Testing Goodwill for Impairment (ASC 350)	Fiscal years beginning after 15 December 2011[1]
ASU 2011-07 — Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (EITF Issue 09-H; ASC 954)	First annual period ending after 15 December 2012 (and interim and annual periods thereafter)
ASU 2011-05 — Presentation of Comprehensive Income (ASC 220)	Fiscal years ending after 15 December 2012 (and interim and annual periods thereafter)
ASU 2011-04 — Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASC 820)	Annual periods beginning after 15 December 2011
ASU 2011-03 — Reconsideration of Effective Control for Repurchase Agreements (ASC 860)	Periods beginning on or after 15 December 2011
ASU 2011-02 — A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring (ASC 310)	Annual periods ending on or after 15 December 2012 (including interim periods within those annual periods)
ASU 2010-28 — When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (EITF Issue 10-A; ASC 350)	Fiscal years (and interim periods within those years) beginning after 15 December 2011
ASU 2010-26 — Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (EITF 09-G; ASC 944)	Fiscal years (and interim periods within those years) beginning after 15 December 2011

Effective after 2012 (for private calendar year-end companies)	
ASU 2012-02 — Testing Indefinite-Lived Intangible Assets for Impairment (ASC 350)	Fiscal years beginning after 15 September 2012[2]
ASU 2012-01 — Continuing Care Retirement Communities — Refundable Advance Fees (ASC 954)	Fiscal periods beginning after 15 December 2013
ASU 2011-11 — Disclosures about Offsetting Assets and Liabilities (ASC 210)	Annual reporting periods beginning on or after 1 January 2013 (and interim periods within those annual periods)
ASU 2011-10 — Derecognition of in Substance Real Estate — a Scope Clarification (EITF Issue 10-E; ASC 360)	Fiscal years ending after 15 December 2013 (and interim and annual periods thereafter)
ASU 2011-06 — Fees Paid to the Federal Government by Health Insurers (EITF Issue 10-H; ASC 720)	Calendar years beginning after 31 December 2013

[1] The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after 15 December 2011.

[2] The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after 15 September 2012.

Reference library

Click on any of the Ernst & Young publications below, all of which are available free of charge on AccountingLink at http://www.ey.com/us/accountinglink.

To the Point

- Final conflict minerals rule addresses many stakeholder concerns (24 August 2012)
- Oil, gas and minerals issuers must disclose payments to governments (24 August 2012)
- FASB proposes more AOCI reclassification disclosures (23 August 2012)
- Sustainability reporting gets a boost from stock exchanges (23 August 2012)
- No IPEs, but fair value could still be an option (9 August 2012)
- Private companies – a framework for consideration (9 August 2012)
- Qualitative impairment added for indefinite-lived intangibles (27 July 2012)
- SEC staff releases Final Report on IFRS (17 July 2012)
- FASB drops loss contingencies disclosure project (12 July 2012)
- Liquidation accounting would be required when liquidation is imminent (3 July 2012)
- SEC requires listing standards for compensation committees (25 June 2012)
- Now is the time to address disclosure overload (21 June 2012)
- Circling back to straight-line leases but with a twist (14 June 2012)
- Spotlight on private company standard setting (14 June 2012)
- PCAOB public meeting on auditor independence and audit firm rotation (27 March 2012)
- PCAOB explores changes to the auditor's report (30 June 2011)

Technical Line

- New principles and criteria for assessing the quality of XBRL files (23 August 2012)
- Lessons from our review of restatements (7 August 2012)
- Liquidity and interest rate risk – new disclosures proposed for all entities (29 June 2012)
- IPO financial statement accounting and disclosure considerations (14 June 2012)
- Supreme Court ruling on health care law could affect financial reporting (13 June 2012)
- Respondents to PCAOB overwhelmingly oppose mandatory audit firm rotation (5 January 2012)

Financial reporting developments

- Intangibles – Goodwill and other (August 2012)

Archived webcasts

- Accounting for income taxes: a quarterly perspective (26 June 2012, Duration: 01:01)
- Ernst & Young Q2 2012 financial reporting update (7 June 2012, Duration: 01:30)

Other

- SEC in Focus (July 2012)
- The new fair value disclosures: A snapshot of how public companies adopted the requirements of ASU 2011-04 (10 July 2012)
- Quarterly tax developments (June 2012)
- The Sarbanes-Oxley Act at 10 (2 July 2012)
- BoardMatters Quarterly (June 2012)
- Second Quarter 2012 Standard Setter Update (July 2012)
- EITF Update – June 2012 meeting highlights (June 2012)
- Joint Project Watch: FASB/IASB joint projects from a US GAAP perspective (June 2012)

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Periodic Report on Investments

Leslie Wiley
Treasury Manager

Finance & Audit Committee
ERCOT Public
November 12, 2012

Investment Compliance

Standard	Compliance
Money market mutual funds invested in U.S. treasury securities or a combination of U.S. treasury securities and repurchase agreements backed by U.S. treasury securities.	Yes
Credit Analysis reviewed by Investment Officers	Yes
Concentration analysis reviewed by Investment Officers	Yes
No more than 40 percent of the portfolio shall be invested in repurchase agreements across all money market mutual funds.	Yes
No more than 10% of investable funds will be maintained in any one fund.	Yes
Direct Treasuries reviewed by Investment officers	Yes - No treasuries purchased directly.
Has assets under management in the fund of at least $1 billion	Yes

Electric Reliability Council of Texas, Inc.
Summary of Investment Results
As of September 30,2012
(in 000's)

Investment Funds (Note 1)	Balance	Interest	Yield	% of portfolio
BlackRock Institutional T-Fund (60) MMF	-	-	0.00%	0.0%
BlackRock Institutional Treasury Trust Fund MMF	43,001	-	0.00%	9.1%
Dreyfus Treasury Prime Cash Management MMF	43,000	-	0.00%	9.1%
Federated Fund 068 Treasury Obligations Fund		-	0.00%	0.0%
Federated Fund 0125 US Treasury Cash Reserves Fund	43,000	-	0.00%	9.1%
Fidelity 695 Institutional MMF: Treasury Portfolio	-	-	0.00%	0.0%
Fidelity 680 Institutional MMF: Treasury Only Portfolio	1,000	-	0.00%	0.2%
Goldman Sachs Treasury Instruments Fund 506	43,000	-	0.00%	9.1%
Invesco Institutional Treasury Portfolio	43,011	0.8	0.01%	9.1%
JP Morgan Chase US Treasury Plus MM Fund	43,000	-	0.00%	9.1%
Morgan Stanley Fund 8304 Treasury	43,007	1.1	0.01%	9.1%
State Street Global Advisors Institutional Treasury MMF	43,000	-	0.00%	9.1%
UBS Select Treasury Preferred Fund 46	43,002	0.4	0.00%	9.1%
Wells Fargo Institutional Treasury Plus MMF	35,003	0.3	0.00%	7.4%
Wells Fargo 100% Treasury MMF	6,000	-	0.00%	1.3%
Western Asset Institutional US Treasury Reserves	43,005	0.6	0.01%	9.1%
Sub-Total	472,029	3.2		100.0%
Other cash net of outstanding checks (Note 2)	82			
Total cash and cash equivalents (est)	472,111			

Benchmark data (Note 3)

Four Week T-Bill: 0.06%

Other open relevant Treasury MMFs: 0.01% (Range: 0.00% - 0.02%)

Notes

Note 1: In compliance with the Investment Corporate Standard, these funds invest in Treasuries or obligations backed by US Treasuries.

Note 2: All other cash, net of outstanding checks, held by ERCOT in bank accounts as of September 30, 2012.

Note 3: Benchmark data obtained as of September 30, 2012 for T-Bills and for comparable funds for which quotes are periodically obtained. Funds not currently open for investment are not included in range. Note that due diligence has not been performed on funds included in the benchmark and included funds may not meet ERCOT investment standards.

Note 4: Monthly holding reports are available for review upon request.

Statement of Compliance

Upon a review of the investment activity, I have no knowledge of any ERCOT action that does not comply with that required by the Investment Corporate Standard since the last report provided to the Finance and Audit Committee.

Signature on File

Michael Petterson Vice President Finance and Treasury

Repurchase Agreement Analysis

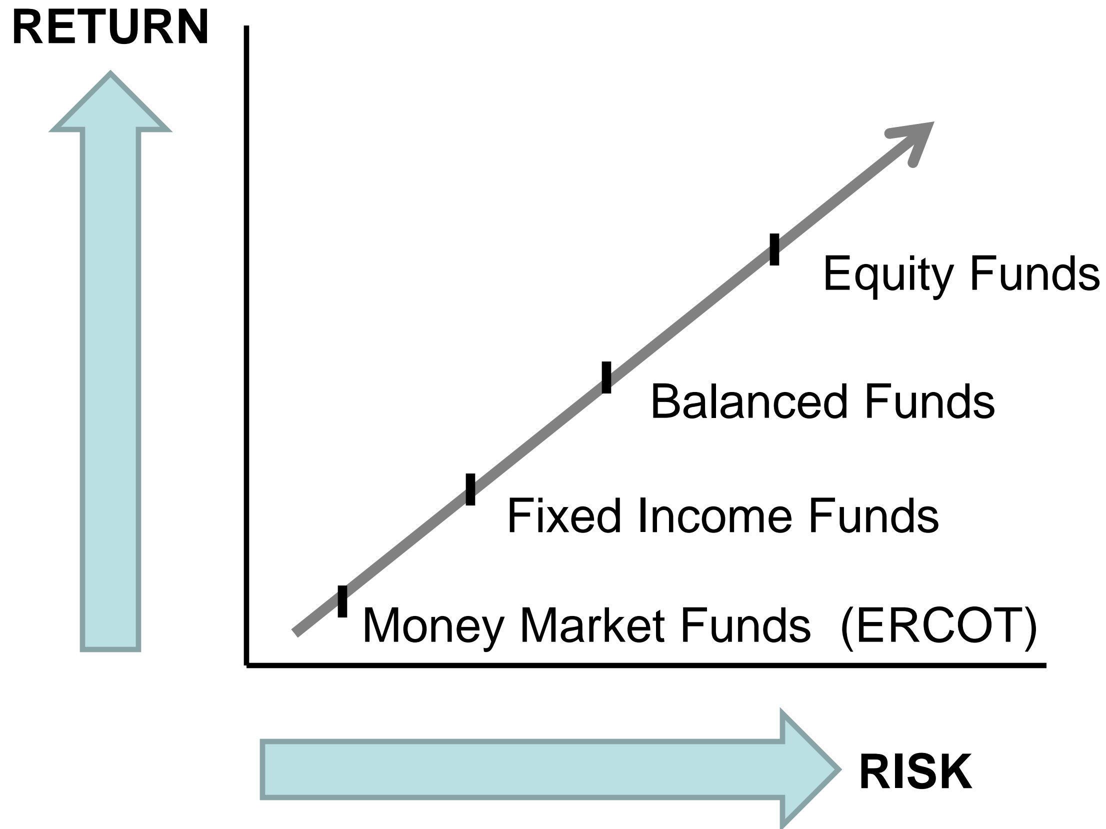
Instrument	Date	ERCOT Value	Percent of ERCOT Portfolio
Treasuries	09/30/2012	$358,932,190	76.04%
Repurchase Agreements		$113,097,061	23.96%
Total		**$472,029,251**	**100%**

Tri-Party Repo Transaction

Repo Investment Date

Repo Maturity Date

Fund Risk



Tri Party Collateral

- **Collateral is held by a third party custody bank**
  - Minimum of 102%
  - Trued up daily
  - Held in trust
  - Held off balance sheet

Rule 2a-7 Requirements

Topic	Requirement
Daily Liquidity	For all taxable money market funds – 10% of assets in cash, U.S. Treasury securities, or securities that can be converted (mature) into cash within one day.
Weekly Liquidity	For all money market funds (includes tax exempt) – 30% of assets must be in cash, U.S. Treasury securities, certain other government securities of 60 days or less, or securities that convert into cash within one week.
Illiquid Securities	Restricts limit to 5% of assets and redefines illiquid as any security that cannot be sold or disposed of within 7 days at carrying value.
Periodic Stress Tests	Require fund managers to examine the fund's ability to maintain a stable NAV in the event of shocks such as interest rate changes, higher redemptions and changes in credit quality.
Know Your Investor Procedures	Funds need to develop procedures to identify investors whose redemption requests may pose risks to funds. Funds would need to anticipate the likelihood of large redemptions.
Weighted Average Maturity (WAM) Limits	Restricts WAM to 60 days
Weighted Average Life (WAL) Limits	Restricts WAL to 120 days.