

## **Board Discussion**

# **Internal Control Certification and Audit**

June 9, 2004

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### **Purpose**

The Audit Committee proposes bylaw amendments that would require the chief executive and financial officers of Energy Trust to certify the integrity of the organization's internal control procedures, and our auditors to address internal control issues in an audit report. The Committee does not ask the board to adopt these bylaw amendments at this meeting, but to direct staff to analyze and comment on the proposals so the board can consider adopting them at the next board meeting.

### **Budget impact**

Perkins and Co. estimated that an internal control audit would add about 30% to audit costs. There would also be costs in staff support associated with an internal control audit and certification.

### **Background**

The proposed amendments are inspired by federal legislation called the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley doesn't apply to Energy Trust, but some commentators think that Sarbanes-type protections, or some of them, may become "best practices" for non-profit corporations. The Audit Committee's proposal, then, is that the board consider these changes as a matter of policy, not legal necessity.

### **Analysis**

Energy Trust governance documents already address many of Sarbanes issues. Here is a thumb-nail analysis of three issues that have not yet been addressed, which are the subject of the Audit Committee's proposal:

I. Written code of ethics

Sarbanes (section 406) requires companies to have a "code of ethics," with provisions to require:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

- Full, fair, accurate, timely and understandable disclosure in the periodic reports required to be filed by the issuer;
- Compliance with applicable governmental rules and regulations; and
- Provisions for accountability, including internal reporting of possible violations.

The code must apply to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, officers and directors. Sarbanes requires companies that do not have codes of ethics to explain why not.

A pre-existing ethics code may satisfy these requirements. Currently, Energy Trust has nothing called a code of ethics, but does have provisions in the bylaws and the charter of the Audit Committee that serve some of the same purposes. The bylaws have conflict-of-interest rules and the Audit Committee is charged with “reviewing policies and procedures with respect to transactions between it and its officers, directors, or affiliates of officers or directors, or transactions that are not a normal part of the Trust’s business.” (Audit Committee Responsibilities Chart, #19).

## 2. Principal executive and financial officer certification of reports

Sarbanes requires principal executive and financial officers to include a certification in periodic reports that they have:

- they have reviewed the report;
- to their knowledge, the report contains no untrue statement of fact;
- to their knowledge, the financial information fairly presents all material aspects of the corporation’s financial condition;
- they are responsible for: (a) establishing and maintaining the company’s internal controls; (b) ensuring that those controls have been designed to ensure that material information relating to the corporation is known to the officers and others; and (c) they have evaluated the effectiveness of these controls; and
- they have: (a) disclosed significant deficiencies in the design or operation of internal controls; (b) disclosed any fraud that involves any employees who have a significant role in the corporation’s internal controls; and (c) noted any significant changes in the corporation’s internal controls.

Currently, there is no such certification. Moreover, the principal executive and financial officers’ function may be in transition.

## 3. “Internal control report”

Section 404 of Sarbanes-Oxley directs the SEC to prescribe rules that would require each annual report that a company files pursuant to Section 13(a) or 15(d) of the Exchange Act to contain an internal control report stating:

management's responsibilities for establishing and maintaining adequate internal controls and procedures for financial reporting for the company; management's conclusions about the effectiveness of the company's internal controls and procedures for financial reporting as of the end of the company's most recent fiscal year; and that the company's registered public accounting firm has attested to, and reported on, management's evaluation of the company's internal controls and procedures for financial reporting.

See Securities and Exchange Commission, Proposed Rule: Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002 (<http://www.sec.gov/rules/proposed/33-8138.htm>).

Currently, independent auditors “express an opinion on” financial statements prepared by Energy Trust management, including:

- Examination on a test basis of evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management
- Evaluating the overall financial statement presentation
- An opinion whether the financial statements “present fairly, in all material respects, the financial position” of Energy Trust as of a certain date, and whether “the changes in its net assets and its cash flows for the year then ended [were] in conformity with [generally accepted] accounting principles.”

## **Recommendation**

Adopt the following resolution:

### **RESOLUTION REGARDING CERTIFICATION AND AUDIT OF ENERGY TRUST OF OREGON'S INTERNAL CONTROL STRUCTURE**

#### **WHEREAS:**

1. It is the policy of the Energy Trust of Oregon, Inc. to conduct its business fairly and honestly, and to ensure that its financial reports are complete and transparent.
2. Energy Trust has processes and standards currently in place to guard against personal financial activities that might compromise or reasonably create the appearance of compromising the organization.
3. The board of Directors of Energy Trust wishes to consider adopting amendments to its bylaws requiring the chief executive and financial officers of Energy

Trust to certify the integrity of the organization's internal control procedures, and requiring our auditors to address internal control issues in an audit report.

**It is therefore RESOLVED:**

I. The board proposes to consider the following amendments to the Energy Trust bylaws:

**Amend section 4 as follows:**

4.10 Treasurer and Principal Financial Officer. The Executive Director may retain a principal financial officer, who shall oversee financial audits and ensure full, fair, accurate, timely and understandable financial disclosure in the Corporation's required periodic reports and certifications described in Sections 4.\_\_\_\_ and 9.\_\_\_\_. The principal financial officer shall keep the Treasurer informed of all the status of and material changes in the finances of the Corporation, and, in cooperation with the Treasurer, ~~The Treasurer shall be the chief financial and accounting officer of the Corporation and shall supervise and monitor the finances of the Corporation. The Treasurer shall ensure that the Corporation~~ (a) ~~cause to be kept~~ keeps correct and complete records of account showing the financial condition of the Corporation, (b) ~~be designates~~ a legal custodian of all moneys, notes, securities, and other valuables that may come into the possession of the Corporation, (c) causes all funds of the Corporation to be deposited in depositories that the board of directors may designate, (d) pays funds only in the manner authorized by the board of directors, (e) presents to the board of directors regular statements of the Corporation's financial position and cash flows, (f) ensure that the Corporation files all necessary tax returns, and (g) maintain the records of all gifts, grants, contributions, gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity that is not an unrelated trade or business, and the sources of all the foregoing funds.

4.\_\_\_\_ Financial reports

(a) Certification. The Corporation's principal executive (see section \_\_\_\_ ) and financial officers (see section \_\_\_\_ ) shall certify in all annual and quarterly financial reports that:

- they have reviewed the report
- to their knowledge, the report contains no untrue statement of fact
- to their knowledge, the financial information fairly presents all material aspects of the corporation's financial condition
- they are responsible for: (a) establishing and maintaining the company's internal controls; (b) ensuring that those controls have been designed to

ensure that material information relating to the corporation is known to the officers and other; and (c) they have evaluated the effectiveness of these controls

- they have: (a) disclosed significant deficiencies in the design or operation of internal controls; (b) disclosed any fraud that involves any employees who have a significant role in the corporation's internal controls; and (c) noted any significant changes in the corporation's internal controls.

(b) Internal control report. Annual financial statements prepared by the Corporation's auditors shall be accompanied by an internal control report that states management's responsibilities for establishing and maintaining adequate internal controls and procedures for financial reporting for the Corporation; management's conclusions about the effectiveness of the Corporation's internal controls and procedures for financial reporting as of the end of the Corporation's most recent fiscal year; and that the Corporation's registered public accounting firm has attested to, and reported on, management's evaluation of the company's internal controls and procedures for financial reporting.

## **Amend section 9 of the bylaws as follows:**

### **SECTION 9 CODE OF ETHICS CONFLICTS OF INTEREST**

9.1 Officers, directors and non-administrative staff of the Corporation. Officers, directors and non-administrative staff of the Corporation shall at all times be mindful of their responsibilities to the Corporation to conduct its business fairly and honestly, and avoid personal financial activities that might compromise or reasonably create the appearance of compromising the Corporation.

9.2 Conflicts disclosure. Annually, all officers, directors and non-administrative staff shall disclose in writing to the Corporation's General Counsel, on such forms and in such formats as shall be established by the directors, any relationships that may be deemed a "direct or indirect conflict of interest," as defined in section 65.361 of the Act, as may be amended and interpreted from time to time. A director of the Corporation shall not be disqualified by the director's office from contracting with the Corporation as vendor, purchaser, or otherwise; nor shall any contract or arrangement entered into by or on behalf of the Corporation in which any director is in any way interested be avoided on that account; provided that such contract or arrangement shall have been approved or ratified ~~under such applicable rules as are contained in the Act~~ by the board or a committee designated by the board.

9.3 Board review of unusual transactions. The board or a committee designated by the board shall review policies and procedures with respect to transactions between the Corporation and its officers, directors, or affiliates of officers or directors, or transactions that are not a normal part of the Corporation's business.

9.4 Principal executive officer and principal financial officer. The Principal executive officer and principal financial officer shall ensure full, fair, accurate, timely and understandable disclosure in the Corporation's required periodic reports and compliance with applicable governmental rules and regulations.

9.5 Reporting concerns. Any person who is concerned that a violation of this code of ethics has occurred may report such concern to the [Option 1: an independent firm to be determined by the board; or Option 2: the Corporation's General Counsel for assessment and a report to the board.]

2. Staff is directed to provide the board with comment on these proposals.
3. The board will consider adopting these proposals at its next meeting.

**Moved by:** \_\_\_\_\_ **Seconded by:** \_\_\_\_\_

**Vote:** \_\_\_\_\_ in favor \_\_\_\_\_ opposed \_\_\_\_\_ abstained

**Adopted on (date)** \_\_\_\_\_ **by Energy Trust of Oregon, Inc., Board of Directors.**