

AUDIT COMMITTEE



2008 Annual Report

January 19, 2009

Introduction

The Audit Committee charter calls for annual reporting to the Board of Commissioners and General Manager about activities, issues and related recommendations. The Audit Committee was created by Resolution No. 04-12597 as a governance best practice and to provide functional reporting independence for Internal Audit. The Committee consists of the President and Vice President of the Board of Commissioners as well as the District's General Counsel, Executive Managers of Operations and District Services and the CFO. On an interim basis the Director of Strategic Financial Planning will serve as a member until the District's CFO/CRO position is filled.

Meetings Summary

March 2008-Quarterly Meeting

Internal Audit discussed their process to the follow-up of prior year audits. Quarterly, a spreadsheet will be sent to the Executive Team and Business Advisors to show progress on how management is addressing audit recommendations. Follow-up audits discussed were;

- FERC Annual Billings
- Engineering Services-Project Procedure Manual Review
- Confluence Technology Center Agreements

The committee received an update that Power Purchasers would begin their audit May 12 and State Auditor's would begin their annual audit on June 23. Discussion on the upcoming performance audit took place.

The Committee heard about two new Statements on Auditing Standards (SAS): No. 114, the Auditor's Communication with Those Charged with Governance and No. 112 Communicating Internal Control Related Matters Identified in an Audit. The new auditing standards will not have a large impact on the District given the fact that the District has in place the current Audit Committee structure.

Committee heard the results of their self assessment taken earlier this year. Questionnaires were sent out to all members, ranking the Committee on organization, oversight of the financial reporting process oversight of the audit processes communications and continuous improvement.

General Counsel reported on the Disclosure Committee's questionnaire that was sent out to the Executive Managers, Directors and Managers. There were no items reported that require new action.

The Committee agreed to add financial risk reporting as a standing item on the agenda. This falls within the Committee's charter oversight role of the financial reporting process. Potential risks discussed by the CRO included credit exposure to banks and potential margin call scenarios with regard to energy trading and interest rates on SWAPs.

May 2008 Special Meeting

A special meeting was held to review the results of the 2007 financial statement audit performed by external auditor, PricewaterhouseCoopers. An unqualified (clean) opinion for the audit has

been issued. No material weaknesses or significant deficiencies were noted. Observations and recommendations were shared with management and the committee.

July 2008 Quarterly Meeting

Accounting reported on the performance of the District's independent auditors, PricewaterhouseCoopers. The Committee had asked for this review. The evaluation included review of the professional services agreement for audit services and engagement letter; research of best practices; a survey of Finance staff; and input from Internal Audit. The evaluation showed favorable ratings and the District is satisfied with the knowledge skills and abilities of PwC staff.

Accounting provided an explanation of why Rock Island has negative Net Assets.

A report was provided on financial risk reporting and the District credit exposure to banks. Management will be watching any exposures closely.

Revisions to the Internal Audit charter were discussed with the Committee.

- Accountability: Internal Audit will provide an assessment on the adequacy of District processes. The assessments will be rated as satisfactory, strong or weak.
- Authority: Internal Audit will work with management regarding the scheduling of audits and workload and the availability of personnel. In order to maintain independence, Internal Audit will not perform any operational duties for the District unless approved by the Audit Committee.
- Responsibility: Internal Audit will perform consulting services to assist management in meeting its objectives.

Also new to the charter were signatures from the General Manager and Audit Committee Chair.

Internal Audit reported on the completion of a follow-up compliance review of the District contracts and agreements. They found 34 opportunities for improvement of which 20 have been resolved and 14 are unresolved. Internal Audit is also recommending more monitoring of service agreements with task authorizations.

Internal Audit has been asked by management to be the liaison with the auditors and independent consultants for the State performance audit. As requested the Audit Committee approved this role as liaison for the performance audit noting that this could cause deviations in the regular Internal Audit work plan. Updates on the work plan will be provided to the Committee.

The RFP was recently published by the State for the Performance Audit.

August 2008 Special Meeting

The State Auditor's reviewed the results of their 2007 audit. The areas audited included accountability for public resources, compliance with state laws and regulations and entity policies. The auditor's reported no findings or management letters (a "clean" audit). A risk based approach to the audit is used to determine those transactions, activities or area that pose the highest risk to the District.

September 2008 Quarterly Meeting

Accounting reported on GASB Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations." The new standard is effective for the 2008 reporting year and provides

for consistency in reporting of pollution remediation obligations that may not have been reported under prior accounting standards.

Internal Audit reported on the status of the risk assessment questionnaire that was completed by certain District employees. This has been a collaborative approach by Compliance, Internal Audit and Finance to assist in identifying risks relevant to each area. Information will be summarized and shared with the Executive Team. Internal Audit will use the results for 2009 audit planning purposes.

Internal Audit has completed its review of certain Human Resources processes. The scope of the audit included risk/control matrixes, payroll time entry and approval, verification of payroll calculations, year-end PL cash-out processes, security access, 457 and 401(a) plans, short term disability and family medical leave eligibility requirements, review of benefit invoice payments, annual salary adjustment process, employee recruitment strategies and compliance with OFCCP guidelines, and employee termination/separation processes. One significant internal control weakness was noted relating to the lack of supporting documentation for benefits and recruiting. The Human Resources Group is addressing the recommendations.

The State Performance Audit has begun. To date, staff time spent on the audit is 716 hours. The auditors have been focusing so far on Procurement and Contract Services and project engineering and management functions. Various directors are being interviewed.

January 2009 Quarterly Meeting

PricewaterhouseCoopers presented their 2008 financial statement audit approach and areas of audit emphasis to the committee. The key audit risks identified for the 2008 audit include the current economic crisis, increased complexity in regulatory oversight, wholesale power and new long-term power contracts, increase in conservation expenditures, significant projects related to new licensing requirements and maintaining system reliability, on-going efforts for FERC license renewal for Rocky Reach, proper implementation of new rates and significant bond refunding. PwC's year-end field work will begin in February, with a tentative opinion date of March 31, 2009.

Internal Audit presented a review of the District's progress in implementing Administrative Policy No. 806 (Control and Tracking of Small Property) which became effective in August 2007. Newly implemented processes for this policy are not perfected at this time and Internal Audit will follow up in 2009 before the State Auditor's return. Internal Audit provided statistics on the monthly review of the District's P-card program.

The Controller reported to the Committee on SEC disclosure regulations. No additional information is required from the District. The amended regulations apply prospectively to July 1.

Status of where Internal Audit ended the year with their 2008 work plan was reviewed. The 2009 Internal Audit work plan was reviewed and approved by the committee.

Internal Audit noted that the Audit Committee self-assessment questionnaires will be sent out within the next couple of weeks. This is a requirement of the charter and results are reported to the Audit Committee at its next regular meeting.