



# Energy Sector Wrestles With Sarbanes-Oxley

By Sanjay Anand and Robert Schwind

■ ■ ■ ENRON.

THE POSTER CHILD for corporate scandal that eventually led to the Sarbanes-Oxley Act of 2002. Since its collapse, much has been written about what contributed to the downfall of the company as well as those that followed. Like it or not, Enron was an energy company and will always be brought up in discussions about regulation (or deregulation) and oversight of the energy industry. Now that the trials of Enron executives have begun, the public is again reminded of the collapse and consequences of the company's failure.

The energy industry has seen its share of regulation and deregulation. Depending on the area of focus (oil, gas, electricity, nuclear, wind, hydro, etc.) the industry contends with many regulations and regulatory bodies, including the Federal Energy Regulatory Commission (FERC), various state public utility commissions, the Department of Environmental Conservation (DEC), the Environmental Protection Agency (EPA), and the Nuclear Regulatory Commission (NRC), just to name a few. Add to that the Sarbanes-Oxley legislation with internal control audit and disclosure requirements, and energy companies find themselves being pulled in many directions to meet all of their regulatory obligations. Sometimes those requirements appear to be in conflict with each other.

One example is when FERC order 2004 required all natural gas and electric public utility transmission providers to comply with standards of conduct that govern the relationship between transmission providers and all of the energy affiliates. The definition of an energy affiliate was expanded to include physical and financial transactions by market and non-market affiliates. Because employees may crossover into both, such as officers and directors and those individuals who must have knowledge of the financial condition of the parent company and the affiliate, conflict of interest violations could arise, as defined in SOX. FERC clarified the requirement that as long as the holding company is not involved in energy transmissions there would be no conflict. But it took hearings and comments for clarification to occur.

Now with record prices for a barrel of oil and record revenues being reported by big oil companies coupled with the new energy bill signed by President

Bush that contains several tax breaks for the various energy sectors plus the repeal of the Public Utilities Holding Company Act (PUHCA), energy companies are poised for what could be a defining moment in the industry. Compliance with the Sarbanes-Oxley Act can only help energy companies as they compete in the competitive global marketplace.

The basic tenets of SOX are simple. Document, test and audit your internal controls over financial reporting. Disclose to the public any material weaknesses. Maintain an independent audit committee. Enact a code of ethics. Provide an anonymous whistleblower process. However, complying with SOX has been one of the most daunting challenges public companies have faced in the last couple of years.

What challenges have energy companies faced? They've faced similar challenges that all companies have had, such as identifying what processes really need to be documented and tested, understanding what is in scope for SOX, and being too reliant on spreadsheets that inherently introduce risk into the operation. However, by identifying and documenting key business processes around the various accounting business cycles and identifying weaknesses and areas of improvements, companies can always find efficiencies. Manual processes especially need to be reviewed and replaced with automated processes whenever possible. The reliance on spreadsheets should be reduced.

Automation examples to improve internal processes include using software to check invoices with original supplier contracts to ensure rates are correct.

Automation has also been used to accurately and consistently estimate unbilled energy and the corresponding unbilled revenue or forecasting unbilled energy to be able to estimate how a month will close. The possibilities depend on individual processes.

The repeal of PUHCA could result in greater overall investment in power transmission and production. The alternate argument is that it could also make corruption and resistance to regulation more likely.

Regardless of what a company now does to comply with SOX, SOX is not going away. It is the law, and in instances of transgressions there are criminal penalties for the CEO and CFO. With all of the opportunity facing energy companies right now, it is a perfect opportunity to make SOX an integral

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A car wash owner has put \$25,000 into the search for natural gas near his Muncie, Ind., car wash. He is drilling 1,000 feet in the hope of finding gas for his business at a time of high energy prices, *Associated Press* reported. "It's always a gamble, because you're drilling into a depleted field and a discontinuous reservoir," said John Rupp, head of subsurface geology at the Indiana Geological Survey, Rupp. "Pockets come and go, and prediction is complex."



aspect of your business. Sarbanes-Oxley should be viewed as an opportunity to develop value-added business processes, improve internal controls and ultimately reduce risk. It is an expensive undertaking. But energy companies that adapt Sarbanes-Oxley compliance efforts to business process and systems improvements may find efficiencies that can cut costs dramatically.



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