



MEMO

Date: January 10, 2006
To: Board of Directors
From: Clifton Karnei, Chairman of the Finance and Audit Committee
Subject: Application of Expected 2005 Actual vs. Budget Revenue Variance

Issue for the ERCOT Board of Directors

ERCOT Board of Director Meeting Date: January 17, 2006

Agenda Item No.: 15a

Issue:

At the November 15, 2005 and January 17, 2006 meetings of the ERCOT Finance and Audit Committee, Committee members reviewed estimates of the expected 2005 Actual vs. Budget variance and considered alternatives for the use of the funds made available by the favorable budget variance. At this time, the Finance and Audit Committee recommends the following action to the Board:

The Finance and Audit Committee recommends that the Board direct ERCOT Staff to apply any favorable budget variances from the 2005 budget year to 1) temporarily fund initial costs incurred in 2006 for wholesale market redesign and 2) to the extent available, reduce outstanding debt or reduce debt-funding of 2005 projects.

Background/History:

ERCOT staff presented financial forecasts of its results of operations for fiscal 2005 to the Finance & Audit Committee and Board of Directors at various times throughout 2005. Each time, ERCOT indicated that a favorable budget variance was expected.

Based on preliminary financial information, ERCOT expects that it will likely have an over-collection of revenues of approximately \$10.1 million for the 2005 budget year. The projected favorable budget variance is primarily the result of operations and maintenance expense under-spending of approximately \$3.7 million, capital expenditure under-spending of approximately \$4.3 million. (\$10.8 million total capital expenditure variance x 40% budgeted revenue-funding of capital expenditures), and higher-than-expected energy consumption in 2005 contributing to an approximately \$2.1 million favorable variance in the ERCOT System Administration Fee and other revenue accounts.

The Committee considered several options regarding how to address the projected over-collection, including (1) reducing the ERCOT System Administration Fee, (2) refunding of a portion of ERCOT System Administration Fee proceeds, (3) increasing 2006 project funding to above the budgeted \$25 million, (4) funding initial wholesale market redesign costs and (5)



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reducing ERCOT debt or reducing the debt-funded portion of 2005 capital project expenditures. The first two options would require approval of the Public Utility Commission.

After discussion at the November 2005 and January 2006 Committee meetings, the Committee arrived upon the recommendation described above.

Key Factors Influencing Issue:

The expected favorable budget variance for the 2005 budget year must be addressed per ERCOT's Financial Policy.

Alternatives:

(1) Approve the recommendation of the Finance and Audit Committee, as recommended or as modified by the Board; (2) Reject the recommendation of the Finance and Audit Committee; (3) remand this issue to the Committee with instructions; or (4) defer action until a later Board meeting.

Conclusion/Recommendation:

The Finance and Audit Committee recommends that the Board approve Alternative (1) as described above.