

**Draft MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING**

Austin Met Center  
8:00 A.M.  
**January 17, 2006**

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at approximately 8:00 a.m. on **January 17, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

**Meeting Attendance**

**Committee members:**

Clifton Karnei, <i>Chair</i>	Brazos Electric Cooperative	Cooperative	Present
Darrell Hayslip, <i>Vice Chair</i>	Calpine Corporation	Ind. Generator	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
Miguel Espinosa	Independent Board Member	Independent Board Member	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor Owned Utility	Present

**ERCOT staff and guests present:**

Barry, Sean (via telephone)	PricewaterhouseCoopers
Byone, Steve	ERCOT (CFO)
Connell, Robert	ERCOT
Doolin, Estrellita	ERCOT
Ettorre, Ed	ERCOT
Giuliani, Ray	ERCOT (CMO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Petterson, Mike	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Yager, Cheryl	ERCOT

Clifton Karnei called the meeting to Order at 8:00 am and welcomed Tom Standish and Scott Gahn as new Committee members.

**Approval of Previous Minutes**

**Mike Espinosa moved to approve the Minutes for the previous regular meeting held December 13, 2005; Darrell Hayslip seconded the motion. The motion passed.**

### **Election of Committee Chair and Vice Chair**

The Committee members discussed the Chair and Vice Chair positions and the Committee's desire to have the current Chair and Vice Chair continue. **Mike Espinosa moved to have Clifton Karnei named Committee Chair. Bob Manning seconded the motion. The motion passed. Mike Espinosa moved to have Darrell Hayslip named Committee Vice Chair. Bob Manning seconded the motion. The motion passed.**

### **Finance & Audit Committee Charter Review**

Mr. Karnei reminded the Committee that it needed to do an annual review of the Committee Charter. The members reviewed and discussed the Finance & Audit Committee Charter dated July 8, 2003. The members agreed that, because the Board currently had only one member from each Segment, the original Charter requirement that each Segment must be represented on the Committee was unworkable, since the HR & Governance Committee meets at the same time and Finance & Audit Committee. Tom Standish suggested that the Committee should have a split between Segment members and independent members, and Mr. Hayslip suggested that the Committee should have at least 5 members.

The members also discussed the requirement that at least one Committee member have past employment experience in finance or accounting and/or professional certification in accounting or other comparable experience or background. The members noted that Mr. Espinosa had significant finance experience, and Mr. Karnei was a CPA with accounting experience and had significant financial oversight responsibilities, thereby providing the Committee with sufficient financial expertise and sophistication.

The Committee voted to amend the Charter, to correct the number of members required from the Segments. **Mr. Espinosa made a motion to amend the first sentence of the Charter to read as follows:**

**"The Finance and Audit Committee of the Board of Directors of ERCOT (the "Committee") shall be comprised of five board members with at least three members from Market Segments, as defined in the Bylaws as well as one or more of the Independent Board members of ERCOT (the "Company")."**

**Mr. Manning seconded the motion. The motion passed.**

The Committee determined that it would ask the Board to vote on the Committee's recommended modifications to the Finance & Audit Committee Charter at the February Board meeting. The Committee further determined that Susan Vincent would be its designated secretary at its meetings. The Committee also discussed doing an additional evaluation of the Committee's performance. Mr. Byone offered to bring suggested additional evaluation materials to the next Committee meeting.

### **Audit Report Acceptance**

Mr. Byone formally requested that the final Benefit Plan Audit, which had previously been provided to the Committee and the Board, be accepted by the Committee. Sean Barry discussed the details of the audit findings, noting that the final paragraph of the audit contained the discussion of certain non-compliant transactions that had been previously discussed by the Committee and for which corrections had been made by ERCOT. Mr. Barry noted that the audit had been a very comprehensive review of all details of the benefits plans. Mr. Espinosa noted that the Committee wanted ERCOT to have a sense of urgency regarding all audit issues in 2006, and the Committee required any remaining items or errors be corrected immediately. Mike Petterson explained that the errors noted in the audit were from the period 1999-2004. Mr.

Petterson explained that, although he did not anticipate any new issues from 2005, because the correction of the previous errors occurred in 2005, the disclosure of the previous errors would be included in the upcoming 2005 audit, as well.

**Mr. Espinosa moved that the Benefit Plan audit be accepted. Mr. Manning seconded the motion. The motion passed.**

### **Committee Briefs**

- 1. Enterprise Risk Management Update.** Don Meek provided an overview of the updated ERM stoplight report, noting that the significant changes related to the failure in the retail transaction system over the holidays. Mr. Meek confirmed that significant efforts were underway to repair the relevant hardware and the ERCOT communication systems. Mr. Espinosa asked if the PUC's primary concern was regarding the communications, and Mr. Byone confirmed that the PUC was concerned about prompt disclosure processes. Mr. Manning and Mr. Karnei suggested some modifications to the appearance and clarity of the chart, including a reversal of the arrows, so that the arrow direction would reflect the risk direction. Mr. Meek explained that a number of management risk reduction initiatives were underway, and that the risk management committee was now meeting monthly to discuss and have managers explain issues in their areas.
- 2. Internal Control Management Process (ICMP) and Audit Point Status.** Cheryl Moseley reported significant progress in addressing gaps, and stated that of the 288 audit points, an additional 47 went into execution in December, a total of 241 were complete, and 223 of the completed points had been verified by the end of December. Ms. Moseley explained that an additional 18 new audit points were added in December (giving a total of 306 audit points), and that these 18 additions were in the planning phase. Ms. Moseley reviewed the materials detailing the ICMP progress and noted that 83.68% were complete and of these 92.53% was verified by the end of 2005.
- 3. Credit Statistics.** Cheryl Yager explained that there was no significant change in credit issues or exposure in December, and she gave an overview of the 2 PRRs with Credit implications that were going before the Board for a vote – PRR 625 and PRR 646. Ms. Yager noted that TAC had taken a different position than the Credit Work Group (CWG) on PRR 646, requesting a (\$1,000) floor for bidding by a Load acting as a Resource, rather than the CWG's recommendation of a \$0 floor. Mr. Karnei, Mr. Hayslip and Mr. Espinosa discussed whether the Committee should take a position on PRR 646, since the TAC recommendation was contrary to the CWG recommendation that would prohibit negative bids. Mr. Manning suggested that the issue be reframed clearly for the Board, since the Board members' fiduciary obligations would require them to close any loopholes and could require them to prohibit negative bids. The Committee determined that it should listen to the TAC rationale before taking a position as a Committee on the PRR. Ms. Yager noted that the major credit issue was mass transition, and that she would discuss this issue at a future Committee meeting.
- 4. Large Projects/PMO.** Rob Connell noted that 67% of the projects on the original 2005 PPL were executed, completed, or cancelled in 2005. Mr. Karnei noted that it appeared that ERCOT had only completed 54% of the 2005 projects (62 of 115), but Mr. Connell explained that 40 projects were added during the year, and of the 109 original projects, 55 were completed and 15 canceled for the 67%. Mr. Connell informed the Committee that all of the Project Management staff was PMP certified and it was doing a very good job. Mr. Manning asked if the staff was using the PMP methodology, and Mr. Connell explained that they are following PMP methodology and are monitoring our capability maturity model, but that they needed to formalize risk mitigation strategies and quality assurance. Mr. Connell gave an overview of 5 large projects. Mr. Connell confirmed to

Mr. Espinosa that the large projects do not include functionality that will be replaced by market redesign initiatives.

### **Quarterly Investment Performance Review**

Ms. Yager gave the Committee an overview of the quarterly investment performance for the 4<sup>th</sup> quarter of 2005 and confirmed that ERCOT was not investing funds in any financial institutions that were market participants. Ms. Yager reviewed with the Committee major requirements of the Investment Policy and the related investment processes and noted that most ERCOT funds were invested in money market mutual funds. Scott Gahn asked what ERCOT would do if its investment risks increased as a result of ERCOT being unable to invest in financial institutions that were also market participants. Ms. Yager explained that there was unlikely to be noticeably increased risk due to the nature of money market mutual funds, however, ERCOT may earn lower rates of return since there would be fewer funds to choose from, and she mentioned that the Committee would be able to monitor this each quarter. Mr. Yager confirmed to Mr. Gahn that money earned on investments (other than security deposits) was retained by ERCOT to meet its operating needs. Interest earned on security deposits is credited to the market participant for whom the security deposit was held... Ms. Yager explained that because Barclay's had recently filed an application to become a market participant, in January 2006 ERCOT moved its investment funds from Barclay's Global Investor funds to The Reserve Fund family of funds.

### **Preliminary 2005 Budget Variance**

Mike Petterson reminded the Committee of their previous discussions about application of the 2005 budget variance. The following actions are under consideration: (1) apply funds to temporarily fund Nodal (market redesign) costs and (2) apply the balance to reduce the debt from 2005 capital projects. Mr. Petterson informed the Committee that preliminary, unaudited financial results indicate fiscal year 2005 ended with a \$10.1 million favorable budget variance. Mr. Hayslip noted that the Committee should consider whether using the money for market redesign first would be the correct application or if this might provide the appearance that the market redesign was less costly. Mr. Karnei informed the Committee that, in response to ERCOT's letter to the PUC, requesting the ability to begin to pay for initial market redesign costs, the PUC had indicated that they preferred that the budget variance be used to pay for initial market redesign costs. Mr. Hayslip questioned how the money should be divided between market redesign and repayment of debt. Mr. Espinosa stated that the repayment of debt and incurrence of new debt should be a cash management issue for ERCOT. Tom Standish noted that, if debt costs increased over the next year, ERCOT would want to consider using the budget variance rather than incurring new, more expensive debt.

**Mike Espinosa moved that the Committee recommend 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 the wholesale market redesign and (2) to the extent available, reduce outstanding debt or reduce debt funding of 2005 projects. Darrell Hayslip seconded the motion. The motion passed.**

### **Overview of Corporate Policy Framework**

Mr. Karnei noted that discussion of the Corporate Policy Framework was moved to the February meeting.

### **Future Finance & Audit Committee Meeting Agenda Items**

Mr. Byone informed the Committee that future Committee agenda items included ABC Objectives & Timeline, PricewaterhouseCoopers Audit Plan, Scope of Third-Party Internal Control Review, SAS 70 Unqualified Opinion Planning, Revised capital project prioritization criteria, Review Credit Working Group Charter (in February or March), Fee Filing Update, Committee Briefs, Investments and Corporate Veil issues.

### **Adjournment**

At approximately 9:25 a.m., the meeting was adjourned and the Committee went into Executive Session. The next meeting will be held on the morning of February 21, 2006.

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Susan Vincent, Acting Secretary

### **F&A Agenda Item # 3 Accept agreed-upon changes to F&A Charter**

As requested, to reduce duplication, this item is included in the February 21, 2006 ERCOT Board of Directors agenda; number 12.

Thank you,

**Becky Brecht**

Becky Brecht  
Executive Assistant-Finance  
ERCOT The Texas Connection  
7620 Metro Center Drive  
Austin Texas 78744  
512.225.7176 office  
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bbrecht@ercot.com



# Electric Reliability Council of Texas, Inc. 2005 Financial Statement Audit Plan

**F&A Committee meeting**  
**February 14, 2006**



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January 17, 2006

To the Members of the Audit Committee  
of the Board of Electric Reliability Council of Texas, Inc.  
7620 Metro Center Drive  
Austin, TX 78744

Dear Audit Committee Members,

We appreciate the opportunity to discuss Electric Reliability Council of Texas, Inc.'s ("ERCOT") relevant business issues and your expectations of PricewaterhouseCoopers as your independent auditors.

We are delighted to present you our audit plan, which includes a summary of our mutual understanding and expectations between you and others within your organization and PricewaterhouseCoopers, an analysis of key risks, our audit approach, reporting and audit timetable and other matters. Discussion of our plan with you ensures our PricewaterhouseCoopers engagement team members understand your concerns and that we agree on mutual needs and expectations to provide the highest level of service quality. Our approach is responsive to the many changes affecting Electric Reliability Council of Texas, Inc..

If you have any questions regarding this plan please contact Sean Barry at (916) 930-8502.

Yours truly,

PricewaterhouseCoopers, LLP



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# Needs and Expectations



- Formal letter of arrangement outlining audit services, deliverables and professional fees for the year end audit of financial statements
- Development and implementation of plan for completion of engagement deliverables (completion/issuance of opinion in April 2006)
- Provide local management with updates related to the status of the engagement as fieldwork progresses.
- Early identification and resolutions of key audit, accounting and/or financial statements issues. Communication of internal control deficiencies noted during performance of substantive auditing procedures.
- Provide local management with access to tax professionals and assist in dealing with corporate tax issues
- Provide local management with audit report for ERCOT

# Fraud Considerations



## PERSPECTIVES ON FRAUD



## AUDIT PLAN

Discussions with senior management, and financial management regarding the risk of fraud.

PwC engagement team will inquire about reported or suspected fraud.

Complete specific fraud procedures:

- Review non-standard journal entries
- Perform analytical procedures, specifically on revenue and accruals
- PwC enhanced audit program will include sections addressing reported or suspected fraud and anti-fraud programs.

# Our Objectives



Our team is directed towards delivering our services at three levels:



- independent opinions and reports that add credibility to financial information released by the Company
- 



- assistance to the audit committee in discharging their corporate governance and compliance responsibilities
- 



- observations and advice on financial reporting, tax and business issues from senior professionals who have an in-depth understanding of your business and industry, including sharing experience on industry best practice issues

# Communications Plan



	Getting started	Understanding the audit	Staying informed	Resolution and completion
	<i>December 2004</i>	<i>December 2004</i>	<i>Ongoing</i>	<i>March-April 2005</i>
<b>Service approach</b>	<ul style="list-style-type: none"> <li>• Communications plan</li> <li>• PwC principles and practices</li> <li>• Engagement letter and independence confirmation</li> </ul>	<ul style="list-style-type: none"> <li>• Our audit plan                             <ul style="list-style-type: none"> <li>– Reporting timetable</li> <li>– Overall scope</li> <li>– Engagement team</li> <li>– Other deliverables</li> </ul> </li> </ul>		
<b>Risk and control</b>	<ul style="list-style-type: none"> <li>• Risk condition alert</li> </ul>	<ul style="list-style-type: none"> <li>• Our audit plan</li> <li>• Risk analysis</li> <li>• Perspectives on fraud risk</li> </ul>	<ul style="list-style-type: none"> <li>• Update on accounting/audit issues and risk analysis</li> <li>• Internal control and business issues report</li> </ul>	
<b>Financial reporting</b>	<ul style="list-style-type: none"> <li>• Transparency of corporate reporting</li> </ul>		<ul style="list-style-type: none"> <li>• Update on accounting/audit issues and risk analysis</li> <li>• Best practices in corporate reporting</li> </ul>	<ul style="list-style-type: none"> <li>• Audit opinion</li> <li>• Reporting requirements                             <ul style="list-style-type: none"> <li>– Internal control recommendations</li> <li>– Accounting policies</li> <li>– Management judgments</li> <li>– Independence</li> <li>– Transparency</li> </ul> </li> </ul>
<b>Governance</b>			<ul style="list-style-type: none"> <li>▪ Corporate governance: roles and practices</li> </ul>	<ul style="list-style-type: none"> <li>• Assessing our performance and yours</li> </ul>

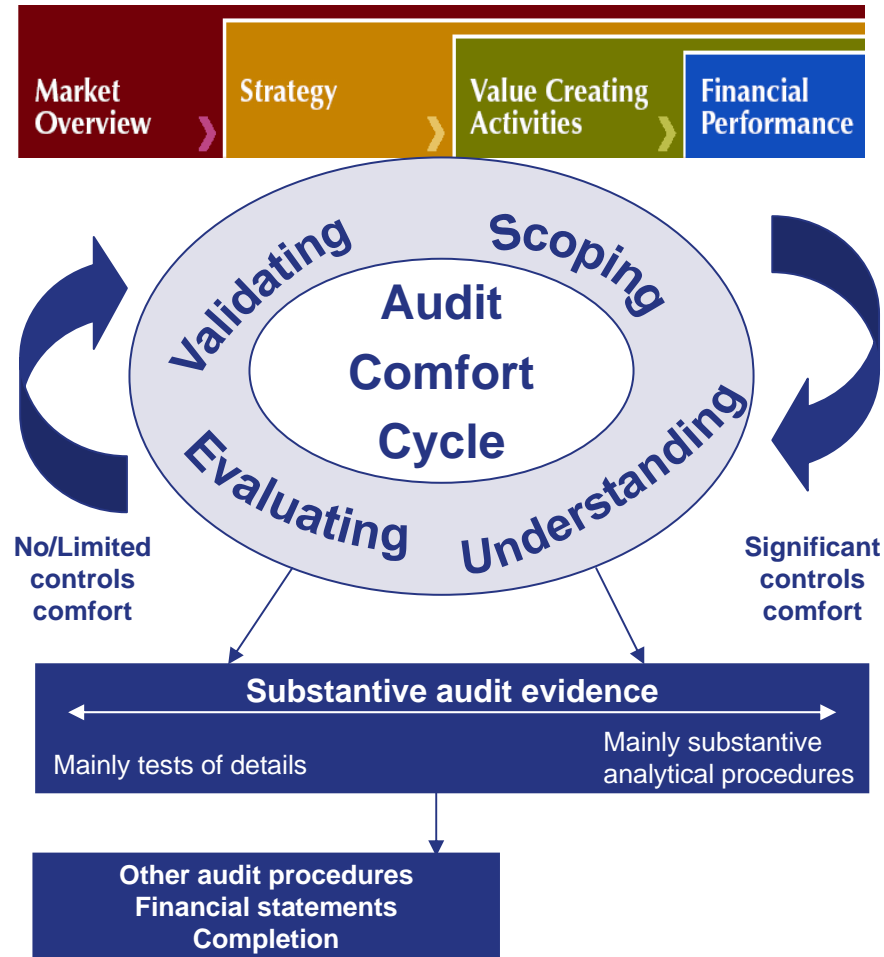
*Ongoing assessment of needs & expectations*

# Audit Approach



Our audit strategy starts at the same point as your business – with your strategies and business objectives. Through discussions with senior and operational management, we understand your business objectives and risks. We then focus our approach on those risks that may materially impact financial statements.

Our “top-down” management discussions not only identify the business objectives and risks, but also key controls in place to manage those risks. We test those management controls. We then determine how we will substantively test significant account balances and classes of transactions.





## Audit Approach cont.

- Risk-based approach considering the following in determining the nature and extent of testing to be performed:
  - Control environment and monitoring controls
  - Materiality in relation to financial statements taken as a whole
  - Cumulative audit knowledge and experience
- Substantive audit at Electric Reliability Council of Texas, Inc. centered on significant system derived accounts related to revenue and receivables, purchasing and payables, fixed asset management, payroll and contract administration and the analysis of non-system derived accounts as needed, relative to financial statement materiality and the information used in the consolidated financial statements of the Company. Highlights of certain accounts and areas of focus are as follows:
- Management to prepare financial statements for current year audit.

# Risk Analysis



Key financial risks: Based on our understanding of the business and discussions with various company personnel, we understand the key financial risks for the current year to be:

<b>Risks that may result in material misstatement</b>	<b>Management's response / controls</b>	<b>Audit approach</b>
<p>Accruals/Provisions - Estimates/Reserves</p> <p>ERCOT establishes reserves and accruals for sales and use tax liabilities. Prior to completion of an audit in 2005, management had failed to recognize liabilities for certain types of accruable costs.</p>	<p>Management has established enhanced processes to collect information and record sales and use tax accruals for all relevant types of activity.</p>	<p>Assess the accruals recorded by ERCOT and determine that all appropriate activities conducted by ERCOT which are subject to Texas sales and use tax have been considered in establishing its accruals. Perform testing of the accruals recorded by ERCOT at December 31, 2005.</p>
<p>Contingencies/Commitments - Significant Contracts/Agreements</p> <p>ERCOT enters into contracts with various third-party vendors to provide services and software development activities. ERCOT had inappropriately capitalized costs associated with certain software development contracts prior to its restatement of 2003 results during mid-2005.</p>	<p>ERCOT has established procedures and controls around its software capitalization process to determine that all costs capitalized have met relevant GAAP tests and have been appropriately approved by management.</p>	<p>Review selection of software projects and determine that projects have been appropriately capitalized or expensed given requirements of current GAAP. Perform tests of costs accumulated for capitalized software projects and determine that costs capitalized are appropriate.</p>





# Risk Analysis

Risks that may result in material misstatement	Management's response / controls	Audit approach
<p>Fixed Assets - Estimates/Impairments</p> <p>Management and outside auditors have identified weaknesses in ERCOT's management and accounting for its fixed assets, including physical identification and costs capitalized as fixed assets.</p>	<p>Management has established procedures to physically identify its fixed assets and determine appropriate valuation of all fixed assets.</p>	<p>Assess the results of management's physical inventory of fixed assets. Perform testing of a selection of fixed assets to determine existence and appropriate valuation.</p>
<p>Fraud Risk</p> <p>Certain former members of senior management and management were in early 2005 indicted and prosecuted for involvement in fraudulent activity affecting ERCOT.</p>	<p>ERCOT's board of directors and management have established enhanced procedures and controls to prevent and detect management fraud.</p>	<p>Document critical matters concerning PwC's consideration of fraud at ERCOT. Engage Fraud Risk &amp; Controls specialists in reassessing fraud risk at ERCOT. Complete fraud risk assessment and perform testing of key risks identified in assessment.</p>



# Risk Analysis

<b>Risks that may result in material misstatement</b>	<b>Management's response / controls</b>	<b>Audit approach</b>
<p>Intangibles - Estimates/Impairments</p> <p>ERCOT has significant amounts of capitalized software costs recorded on its balance sheet. Software is subject to impairment or changes in its economic useful lives.</p>	<p>Management has established procedures and controls to evaluate and assess the reasonableness of its software amortization lives and assess the continued usefulness of capitalized software costs.</p>	<p>Review management's procedures for assessing the continued capitalization and amortization periods assigned to capitalized software costs. Perform testing of assigned amortization lives for a selection of software projects.</p>

# Audit Approach cont.



Audit Area	
<p>Planning phase</p>	<ul style="list-style-type: none"> <li>• Business based interviews with executive management</li> <li>• Careful review of internal and external reports on internal controls including consulting reports issued by Deloitte and Touche LLP in 2004 and 2005; internal audit reports; and internal reports summarizing ERCOT’s response to identified control weaknesses.</li> <li>• Interviews with key staff to understand the nature of changes in internal controls that have occurred since our 2004 audit – specifically, we will meet with Cheryl Moseley, responsible for ERCOT’s Internal Control Management Program, Mike Petterson, controller responsible for much of the internal controls supporting financial reporting and Steve Byone, newly appointed CFO.</li> <li>• Developments of overall risk assessment and audit strategy for significant areas</li> <li>• Obtain and updated key documentation of systems, processes and key monitoring of controls</li> <li>• Perform an analysis of new significant contracts and changes in existing contracts</li> <li>• Communication of audit plan with management</li> <li>• Communication of the audit plan to the Finance &amp; Audit Committee (F&amp;A Committee); consistent with past practice some of the content of our communication of the Audit approach will include:             <ul style="list-style-type: none"> <li>–Audit overview – timing, approach, etc.</li> <li>–Key risks area</li> <li>–Agreed-upon needs and expectations</li> <li>–Direct feedback/concerns from F&amp;A Committee</li> <li>–Private communications with the F&amp;A Committee Chairman</li> </ul> </li> </ul>

# Audit Approach cont.



Audit Area	
Execution phase	<ul style="list-style-type: none"> <li>• Tests of significant transactions, including but not limited to, each of your primary processing systems               <ul style="list-style-type: none"> <li>–Administrative fees and other revenues</li> <li>–Payroll and employee benefits</li> <li>–Major contract expenditures</li> <li>–Major contractor expenditures</li> <li>–Other disbursements including software/system development</li> <li>–Capital assets (including capitalization of indirect costs, internal costs, etc.)</li> </ul> </li> <li>• Various audit tests of accounting records including monthly and year-end cutoff and reporting entries</li> <li>• Analytical review of operation results</li> <li>• Evaluation of significant accounting and reporting matters, including:               <ul style="list-style-type: none"> <li>–Recording of losses relating to known irregularities</li> <li>–Recording probably recoveries from insurance or other sources for claims associated with known irregularities</li> <li>–Fixed asset inventory/reconciliation</li> <li>–Cutoff issues relating to system development</li> <li>–FAS 95 cash flow settlement process</li> <li>–Sales tax liability assessment</li> </ul> </li> <li>• Communication of audit results to management on periodic basis throughout the audit</li> <li>• Communication of significant aberrant audit results (if any) to the Finance &amp; Audit Committee extemporaneously</li> </ul>

# Audit Approach cont.



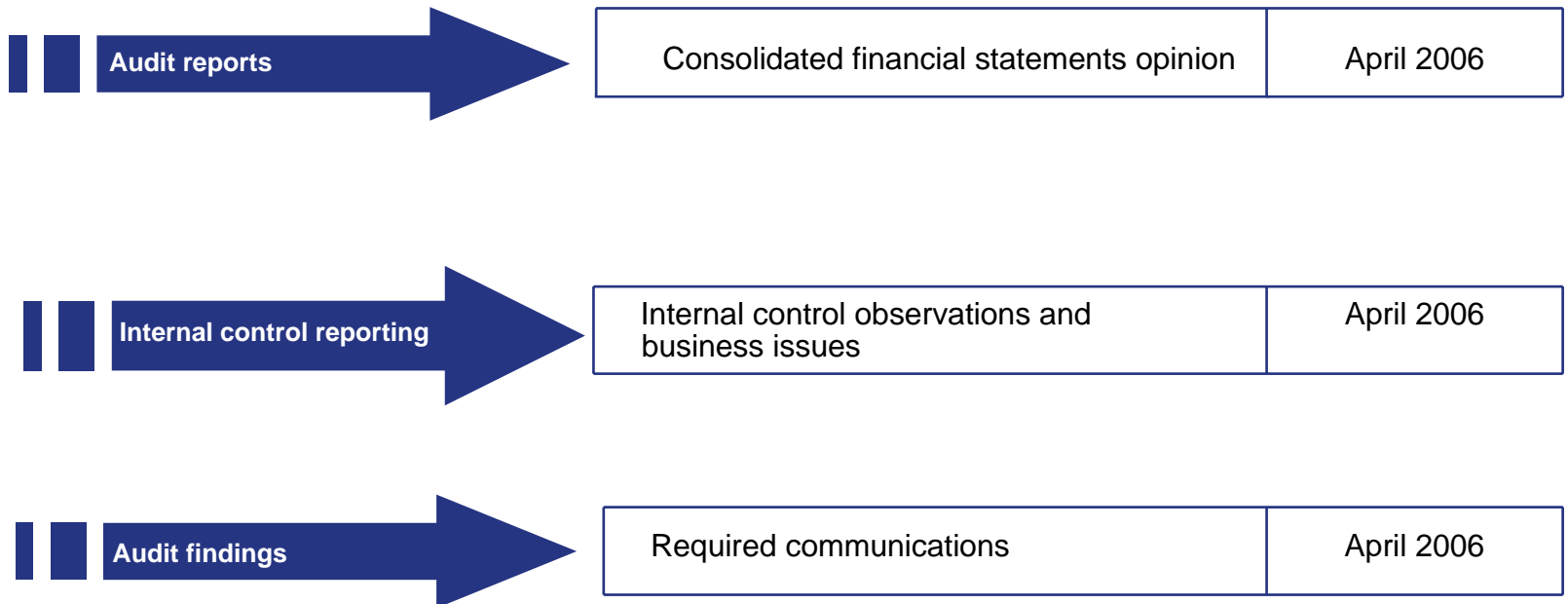
Audit Area	
Reporting phase	<p>Review of the financial statements prepared by management</p> <ul style="list-style-type: none"><li>• Suggest modifications to the financial statements to Mike Petterson</li><li>• Meet with finance management – primarily Steve Byone and Mike Petterson - to address and resolve any accounting, reporting or audit issues</li><li>• Development and delivery of process improvement recommendations</li><li>• Reporting to the F &amp; A Committee – During April 2006 Meeting<ul style="list-style-type: none"><li>–Results of audit</li><li>–Financial statement highlights</li><li>–Material weaknesses, reportable conditions, scope limitations, other challenges</li><li>–Internal Control recommendations</li></ul></li></ul>

# Reporting timetable



## Reporting/deliverables:

Your PricewaterhouseCoopers team works on the engagement throughout the year to provide Electric Reliability Council of Texas, Inc. with timely, responsive service. Below are the dates you can expect our reports.



# PwC Service Team



<b>Role</b>	<b>Name</b>	<b>Office Phone</b>	<b>Office Fax</b>	<b>Email</b>
Quality Review Partner	Mark Niehaus	(267) 330-2100	(813) 329-3127	mark.niehaus@us.pwc.com
Engagement Leader	Sean Barry	(916) 930-8502	(813) 375-5447	sean.d.barry@us.pwc.com
Engagement Manager	James West	(512) 708-5638	(813) 375-5501	james.k.west.jr@us.pwc.com
SPA Engagement Senior Manager	Lon Heuer	(512) 708-5500	(813) 375-5554	lon.s.heuer@us.pwc.com
Tax Engagement Partner	Mike Lane	(512) 708-5634	(813) 637-4754	mike.lane@us.pwc.com
Tax Engagement Senior Manager	Pat Dunnahoo	(512) 708-5613	(813) 741-4438	patrick.a.dunnahoo@us.pwc.com



# Audit Planning

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**Benefit Plans Follow-up Discussion**  
**Nancy McIntire**  
**Vice President of HR**  
**& Organization Development**

**Finance & Audit Committee**  
**February 21, 2006**





# Audit Planning

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**SAS 70**

**Steve Byone**

**Chief Financial Officer**

**Finance & Audit Committee**

**February 21, 2006**

- ❑ Management actions to address previous deficiencies
  - Assembly of SAS70 Readiness Team
  - User Provisioning (Cyber and Physical Security)
    - Project underway to eliminate manual touch points
    - Manual update of all user access privileges (re-certification)
    - Manual review of approval strings as compared to access granted
    - Manual update of approval strings and access as documented
  - Hardening Standards (Cyber Security)
    - Identify and review infrastructure standards for systems, databases and network devices
    - Establish single authoritative source for valid standard documents for implementation and compliance monitoring
  - Closed Circuit Television (Physical Security)
    - Project underway to replace, relocate and add facility cameras
- ❑ Actions to address ongoing business activities
  - Business managers continually monitor operating procedures for accuracy and relevance
  - Launched a project to automate portions of credit monitoring
- ❑ Pre-audit by Internal Audit of 2005 trouble areas
  - Physical Security – review of exception areas
  - Logical Security – not feasible due to completion dates



# Audit Planning

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**Internal Controls Assessment Discussion**  
**Steve Byone**  
**Chief Financial Officer**

**Finance & Audit Committee**  
**February 21, 2006**



# Audit Planning

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**Sales Tax Audit Discussion**  
**Mike Petterson**  
**Controller**

**Finance & Audit Committee**  
**February 21, 2006**



# **Large Projects Briefing**

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**Robert Connell**  
**Director Program Management**

**Finance & Audit Committee**  
**February 21, 2006**

# 2006 YTD Project Performance

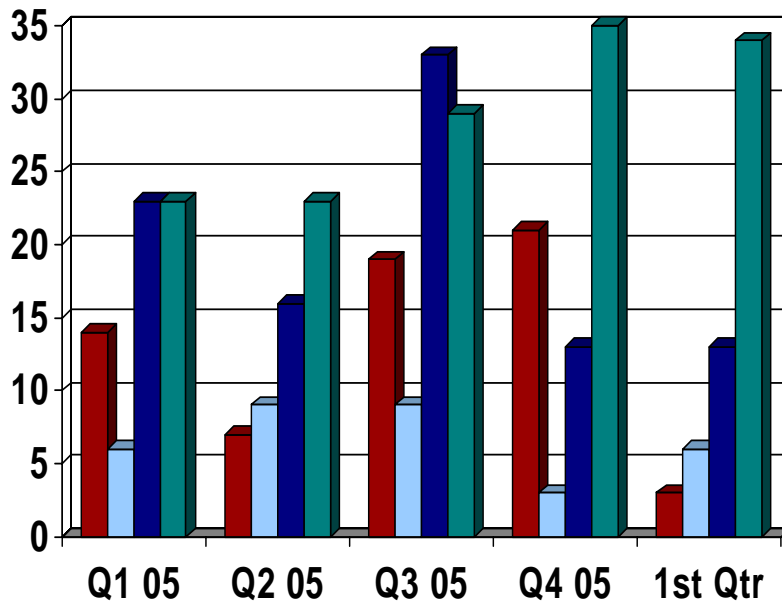
## First Quarter Results (to 1/31)

- 3 completed, 3 YTD
- 6 in Initiation
- 13 in Planning
- 34 in Execution

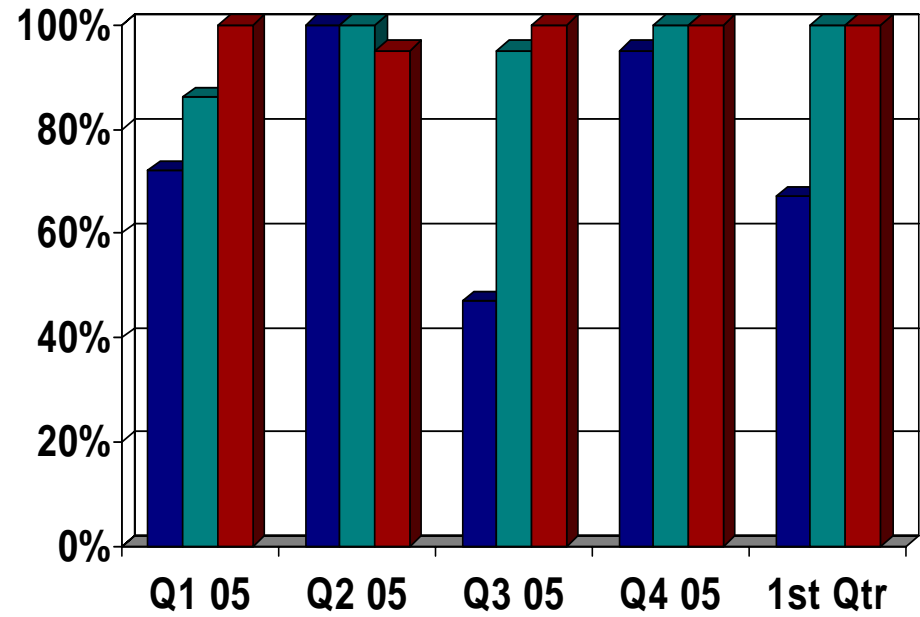
## Projects Completed in January 2006

- PR-50145 Austin Control Ctr Power and Cooling
- PR-40133 RAP-C (Remedial Action Plans for Congestion) Modeling Enhancements
- PR-50033\_02 MV90 (Metering) System Installation

### Project Activity













### Project Performance



■ Completed ■ Initiation ■ Planning ■ Execution

■ On Time ■ On Budget ■ Deliverables

# Major ERCOT Projects Summary

Project	Total Budget	Actual 01/31/06	Metrics			
			Duration/Information (Sponsor)	Phase/Scheduled Completion	Schedule	Budget
<b>Service Oriented Architecture (2004-2006)</b>	<b>\$6.1M</b>	<b>\$5.5</b>				
<i>3 separate projects over 12 mos. (R Giuliani)</i>	<i>Execution Phase/4th Qtr 2006</i>					
<b>Enterprise Data Warehouse (2003-2006)</b>	<b>\$3.5M</b>	<b>\$2.7M</b>				
<i>9 separate projects over 36+ mos. (R. Hinsley)</i>	<i>Execution Phase/2nd Qtr 2006</i>					
<b>Ercot.com Improvements (2004-2005)</b>	<b>\$1.2M</b>	<b>\$920K</b>				
<i>Rewrite of ERCOT web site (R Giuliani)</i>	<i>Completed December 2005</i>					
<b>Enhancements to FasTrak Tools</b>	<b>\$1.2M</b>	<b>\$641K</b>				
<i>In Planning Phase (R Giuliani)</i>	<i>Planning Phase/3rd Qtr 2006</i>					
<b>Enhancements to SCR727 (2005-2006)</b>	<b>\$1.9M</b>	<b>\$305K</b>				
<i>Preliminary Planning over 12 mos. (R Giuliani)</i>	<i>Planning Phase/2nd Qtr 2006</i>					

## Retail Operations Program Area

PR-50007 – Enhancement to FasTrak

Reported in August, was over \$1M and approved for execution

Final project plan requires increase to total project budget

Resolution will be presented for Board approval

PR-60006\_01 – ERCOT Outage Evaluation and Resolution SCR-745

Project over \$1M moving into planning

Inform F&A and Board

PR-50121 – Service Oriented Architecture, TIBCO Implementation

Large 3+ year project over \$1M approved in October 2004

Planning is wrapping up and budget increase will be required

Will present in April for Board approval to move forward

## IT Operations Program Area

PR- 50147 – Windows Domain Restructuring

Project in planning, to support audit issues, may exceed \$1M

Inform F&A project moving to execution

Resolution will be presented for Board approval





# Finance Update

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**Cheryl Yager**  
**Treasurer**

**Finance & Audit Committee**  
**February 21, 2006**

- Term Loan
  - \$12,500,000 – payment due Nov 1, 2006
  - Interest rate paid currently – 4.77 and 4.88%
  - Nov 1st term loan payment is built into revenue requirement (collected in 2006)
  - Prepayments can be made without penalty
  
- TCR revenues – held in money market account
  - Interest income rate at rate set – 4.39%
  - Current interest rate – 4.44%
  
- ERCOT has over \$50.0 million of TCR revenues on hand
  - ERCOT may borrow from TCR revenues

- ERCOT anticipates a 20-40 basis point savings between the rate we will pay for debt compared to what we will earn on money market accounts
  
- ERCOT proposes to prepay the \$12.5 million due November 1, 2006 under the term loan using TCR revenue
  - Expected savings of approx \$16k to \$33k over the 8 month period from Mar 1 through Nov 1
  - TCR revenue funds will be repaid as ERCOT admin fee is collected

- Next steps
  - Determine timing of prepayment (no later than Mar 6)
  - Finalize documentation (minimal)
  - Effect transaction

# Nodal Financing Discussion



## **Committee Brief: ICMP**

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**Cheryl Moseley**  
**ICMP Manager**

**Finance & Audit Committee**  
**February 21, 2006**

- ❑ Currently 683 control activities in controls repository, 200 marked as key controls
- ❑ 702 gaps (many redundancies), 217 specific activities to address or remediate
- ❑ Approval of documents to remediate documentation gaps for business processes will be complete by 3/31/06
  - 6 Corporate Policies approved, 2 in review
  - 11 Corporate Standards approved, 8 in review
  - 12 Operating Procedures approved, 19 in review
- ❑ Additional resources engaged to assist with gap remediation, review/evaluate controls and QA/QC of control design
- ❑ Remediated (gap) control activities under review to update control documentation and load into control repository by 3/31/06
- ❑ Training updates for business processes will be conducted in late Q1 & early Q2
- ❑ Control Self Assessments underway; evaluate effectiveness of controls based on results; responses indicate whether control is fully met, partially met or not met
- ❑ Preliminary testing completed by Internal Audit (Nov-Dec 2005) for management to gauge the effectiveness of controls; noted exceptions are under remediation



## **Committee Brief: Audit Statistics**

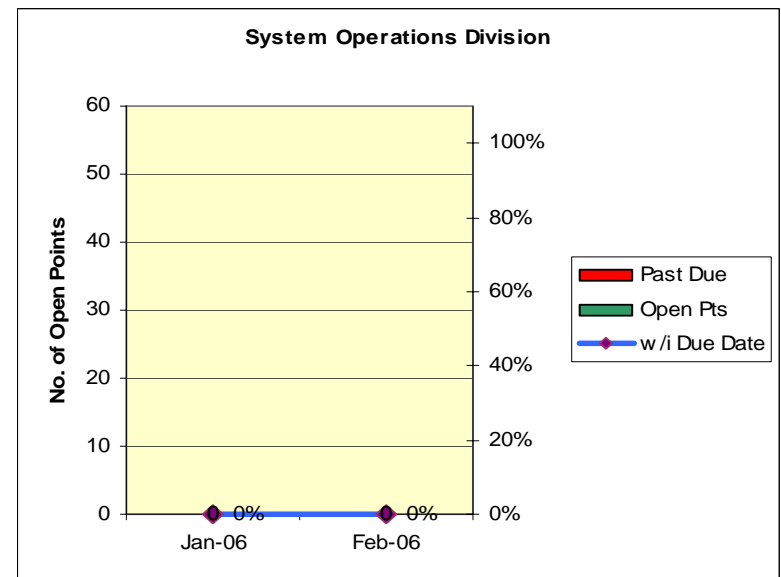
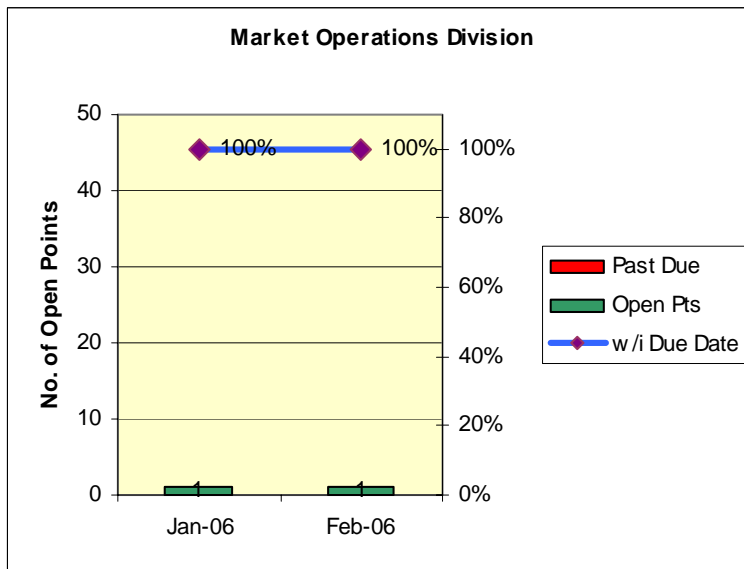
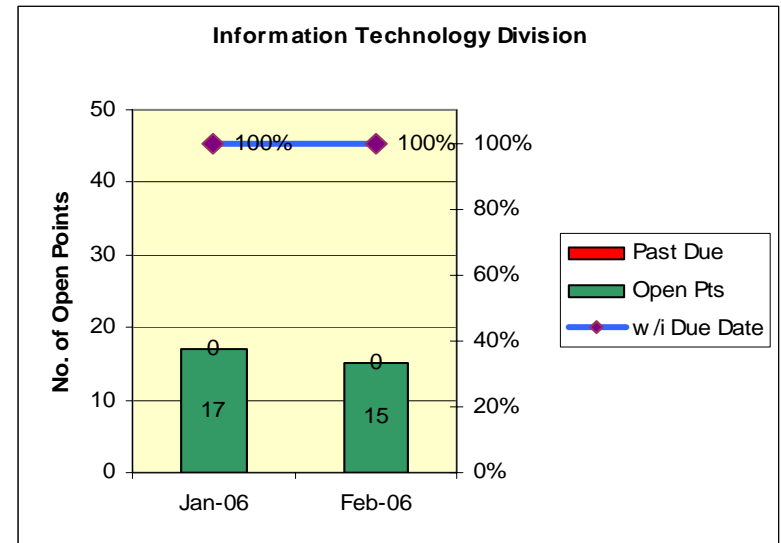
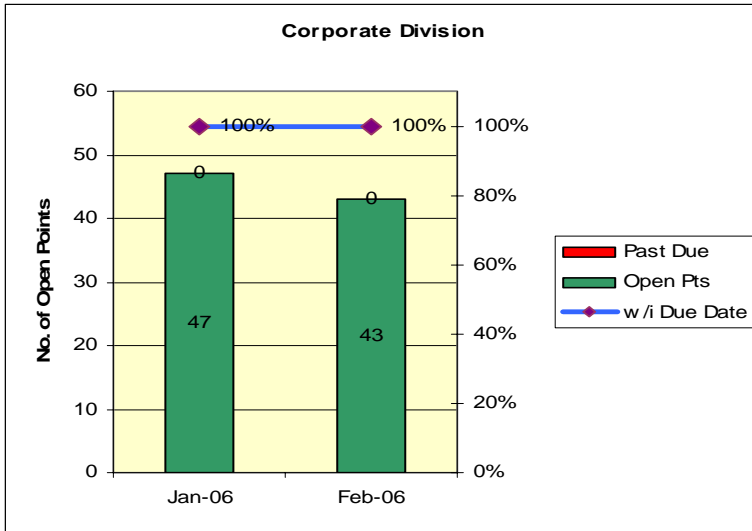
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**Steve Byone**  
**Chief Financial Officer**

**Finance & Audit Committee**  
**February 21, 2006**



# 2006 Audit Points Status



# Audit Program Report

Audits Completed	<u>Open Audits</u>	Planned Audits
(last 3 months)		(next 3 months)
<u>Internal Audits</u>	<u>Internal Audits</u>	<u>Internal Audits</u>
<ul style="list-style-type: none"> <li>❑ Cash Receipts</li> <li>❑ Testing of Key Internal Controls</li> </ul>	<ul style="list-style-type: none"> <li>❑ Congestion Management/ TCR</li> <li>❑ Market Operations</li> <li>❑ Cyber Security</li> <li>❑ EMMS</li> <li>❑ General Ledger Entries</li> <li>❑ Fraud Prevention (ongoing)</li> </ul>	<ul style="list-style-type: none"> <li>❑ Payroll</li> <li>❑ Lawson HR System</li> <li>❑ Credit</li> <li>❑ Physical Security (Consulting)</li> <li>❑ Data Warehousing</li> </ul>
<u>External Audits</u>	<u>External Audits</u>	<u>External Audits</u>
<ul style="list-style-type: none"> <li>❑ 2004 Benefits Audit (PwC)</li> <li>❑ 2005 SAS70 (PwC)</li> </ul>	<ul style="list-style-type: none"> <li>❑ 2005 Financial Audit (PwC)</li> </ul>	<ul style="list-style-type: none"> <li>❑ 2006 SAS70 (PwC)</li> <li>❑ Review of Internal Controls (TBD)</li> </ul>



## **Committee Brief: Credit Statistics**

**Cheryl Yager  
Treasurer**

**Finance & Audit Committee  
February 21, 2006**

ERCOT Market Credit Status										
	as of 12/31/2005					as of 01/31/2006				
	# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted		# of QSEs*	Estimated Aggregate Liability (\$)	% of EAL	Total Unsec Credit Limit / Security Posted	
<b>Exposure in the ERCOT Market (owed to ERCOT)</b>										
<u>QSEs that meet ERCOT Creditworthiness Standards</u>										
Ratings over BBB-	6	28,222,198	7%	189,916,961	U	9	17,897,890	6%	260,021,639	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated	39	372,578,876	73%	616,567,456	S	35	269,288,033	74%	435,906,494	S
Cash & Letters of Credit	8	107,640,689	20%	209,856,870	S	7	76,454,636	20%	217,700,000	S
Guarantee Agreements										
<b>Total Exposure</b>	<b>53</b>	<b>508,441,763</b>	<b>100%</b>			<b>51</b>	<b>363,640,559</b>	<b>100%</b>		
<b>Other QSEs in the ERCOT Market (ERCOT owes)</b>										
<u>QSEs that meet ERCOT Creditworthiness Standards</u>										
Ratings over BBB-	9	(18,994,795)	-16%	198,534,893	U	6	(2,319,205)	-4%	128,430,215	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated	38	(49,552,143)	-43%	13,982,608	S	42	(24,870,391)	-40%	33,063,169	S
Cash & Letters of Credit	8	(48,603,532)	-41%	86,977,000	S	12	(35,287,447)	-56%	152,277,000	S
Guarantee Agreements										
<b>Total</b>	<b>55</b>	<b>(117,150,470)</b>	<b>-100%</b>			<b>60</b>	<b>(62,477,043)</b>	<b>-100%</b>		
<b>Total</b>	<b>108</b>					<b>111</b>				

U: Unsecured since these QSEs meet the creditworthiness standards

S: Secured i.e. required to post collateral since these QSEs do not meet the creditworthiness standards



# **F&A Committee Self Assessment**

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**Steve Byone**  
**Chief Financial Officer**

**Finance & Audit Committee**  
**February 21, 2006**

	<b>ERCOT Finance &amp; Audit Committee Self-Evaluation Tool</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Comments</b>
1.	Does the committee have the appropriate number of members? The committee should not be so large that: <ul style="list-style-type: none"> <li>▪ its ability to operate efficiently and effectively is reduced</li> <li>▪ members' ability to raise issues is hampered</li> <li>▪ it is difficult to get a quorum when a time-sensitive issue arises</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
2.	Committee members demonstrate their objectivity during meetings through behaviors such as driving agendas, rigorous probing of issues, consulting with other parties, and hiring experts, as necessary.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
3.	Differences of opinion on issues are resolved to the satisfaction of the committee.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
4.	Committee members challenge the Chair as appropriate.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
5.	The committee charter is used as a document to guide the committee in its efforts, and to help guide the committee's agenda.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
6.	6.1 Committee members are financially literate, and the committee has determined that it has adequate financial expertise in accordance with its charter.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.2 The committee has a full understanding of the composition of the organization's statement of financial position, including the degree of management judgment inherent in the various accounts.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.3 The committee understands how the organization's performance compares with its budgetary targets and its peers, and how management plans to address any unfavorable variances.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	<b>ERCOT Finance &amp; Audit Committee Self-Evaluation Tool</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Comments</b>
	6.4 The committee discusses the initial selection of or changes in significant accounting policies used in developing the financial statements, the reason for and impact of any changes in policy, and reasons alternative treatments were not adopted.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.5 The committee discusses significant, complex, or unusual transactions with management and the external auditors.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.6 The committee understands which areas represent high risk for material misstatement of the financial statements, and discusses assumptions and approaches used with management and the external auditors.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.7 The committee forms its own view of the risk of material misstatement due to fraud, discusses with management and the external auditors their views on the risk of material misstatement due to fraud, and is comfortable that any differences in views can be reconciled.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.8 The committee fully understands significant changes in financial statements from prior years and from budget, and is provided with sufficient, reliable evidence to support variances.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.9 The committee commits sufficient time to review, discuss, and consider the financial statements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	6.10 The committee meets with financial management to discuss results reported before finalization.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
7.	Committee members have a clear understanding of ERCOT's debt structure and cash management practices.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
8.	Committee members receive sufficient details regarding long-term financial planning.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
9.	The committee engages outside experts as appropriate.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
10.	10.1 The organization's financial reporting processes are stronger as a result of management's interactions with the committee.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

	<b>ERCOT Finance &amp; Audit Committee Self-Evaluation Tool</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Comments</b>
	<p>10.2 The committee understands and agrees with the board on which categories of internal control it oversees. Categories include:</p> <ul style="list-style-type: none"> <li>▪ Integrity of financial reporting</li> <li>▪ Compliance with laws and regulations</li> <li>▪ Operational efficiency and effectiveness</li> </ul>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	10.3 The committee and the board concur with any changes to the committee's internal control oversight mandate.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
	10.4 The committee understands the current high-risk areas - including information technology and computer systems - in the categories of controls it oversees, as well as how management addresses those areas.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
11.	The committee is cognizant of the line between oversight and management, and endeavors to respect that line.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
12.	The committee conducts executive sessions in a manner that offers a "safe haven" to the individual, while at the same time asking tough and necessary questions, evaluating the answers, and pursuing issues that might arise to a satisfactory resolution.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
13.	Committee members participate in some form of continuing education to stay abreast of changes in the financial accounting and reporting, regulatory and ethics areas.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
14.	The committee does its part to ensure the objectivity of the internal audit team.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
15.	The committee provides constructive feedback to the chief audit executive at least annually.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
16.	The committee communicates at an appropriate level of detail when informing the Board of its actions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	



	<b>ERCOT Finance &amp; Audit Committee Self-Evaluation Tool</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Comments</b>
17.	Committee members receive clear and succinct agendas and supporting written material sufficiently prior to scheduled meetings.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
18.	Committee members have adequate opportunities to discuss issues and ask questions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
19.	The frequency of committee meetings is appropriate for the responsibilities assigned to the committee.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	
20.	Please add additional comments, questions and suggestions here.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

DRAFT



# Future Agenda items

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**Steve Byone**  
**Chief Financial Officer**

**Finance & Audit Committee**  
**February 21, 2006**

## Quarter 1

- *Elect officers and confirm financial qualifications*
- *Review Finance Audit Committee charter*
- Approve the Guidelines for Engagements of External auditors for Other Services (pre-approval policy)
- Review and approve ERCOT Annual Report
- Required written communication and discussion of auditor independence
- *Review scope of annual financial audit*
- **Review EthicsPoint activity**
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review of significant audit findings and status relative to annual audit plan**

## Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Assessment of internal control environment and systems of internal controls
- Review and approval of annual operating budget
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**

## Quarter 2

- Report results of annual independent audit to the board
- Report of external auditor pre-approval status/limits
- Review the procedures for handling reporting violations
- Review conflict of interest and ethics policies
- Review results of annual audit (including required communications)
- **Approve minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**

## Quarter 4

- Approve audit committee meeting planner for the upcoming year, confirm mutual expectations with management and the auditors
- Review and approval of Financial, Investment & Credit policies
- Approve scope of internal auditing plan for upcoming year
- Assessment of the adequacy and effectiveness of the Internal Audit staff
- Perform Finance & Audit committee Self Assessment
- **Review minutes of previous meeting**
- **Report monthly matters to the Board (chair)**
- **Review EthicsPoint activity**
- **Review significant audit findings and status relative to annual audit plan**

# March 21 Agenda Items

- ❑ Committee Briefs (ERM, Credit, ICMM & Audit Points)
- ❑ Corporate Policy Framework
- ❑ Compliance Monitoring
- ❑ Review of CWG Charter
- ❑ Review guidelines for engagements of external auditors for Other Services
- ❑ Nodal Financing
- ❑ ABC