



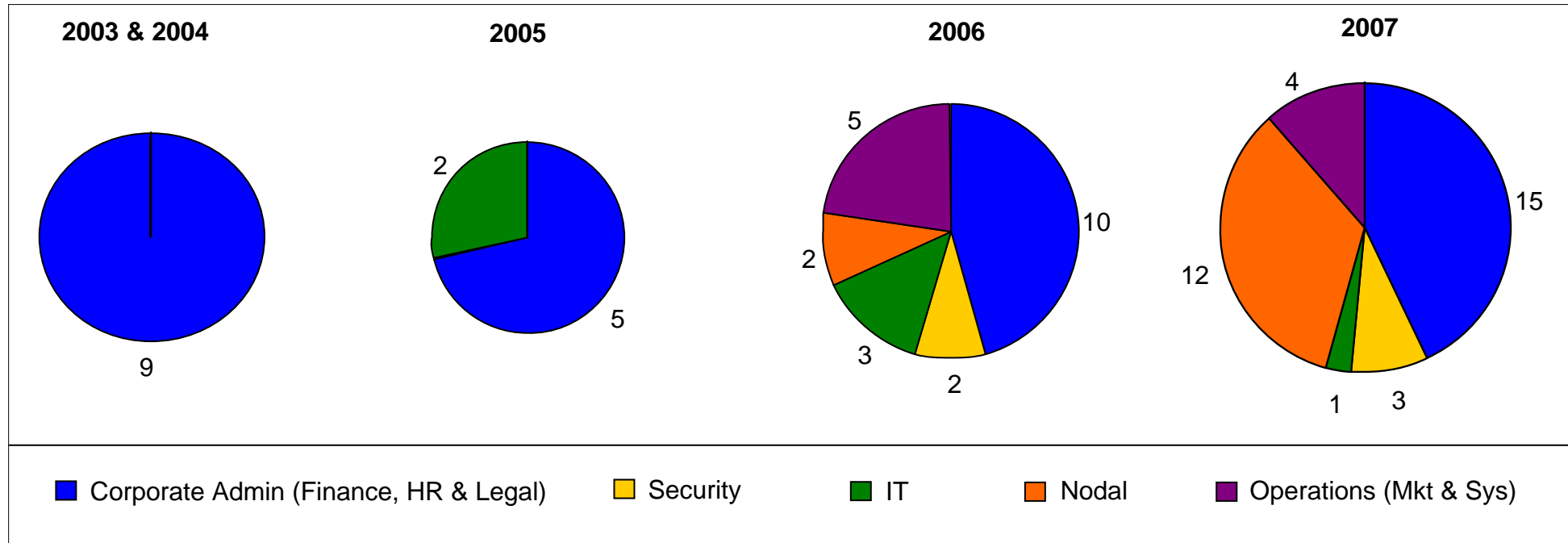
# Compliance & Internal Controls Update

Steve Byone  
Chief Financial Officer

**Board of Directors Meeting**  
**February 19<sup>th</sup>, 2008**

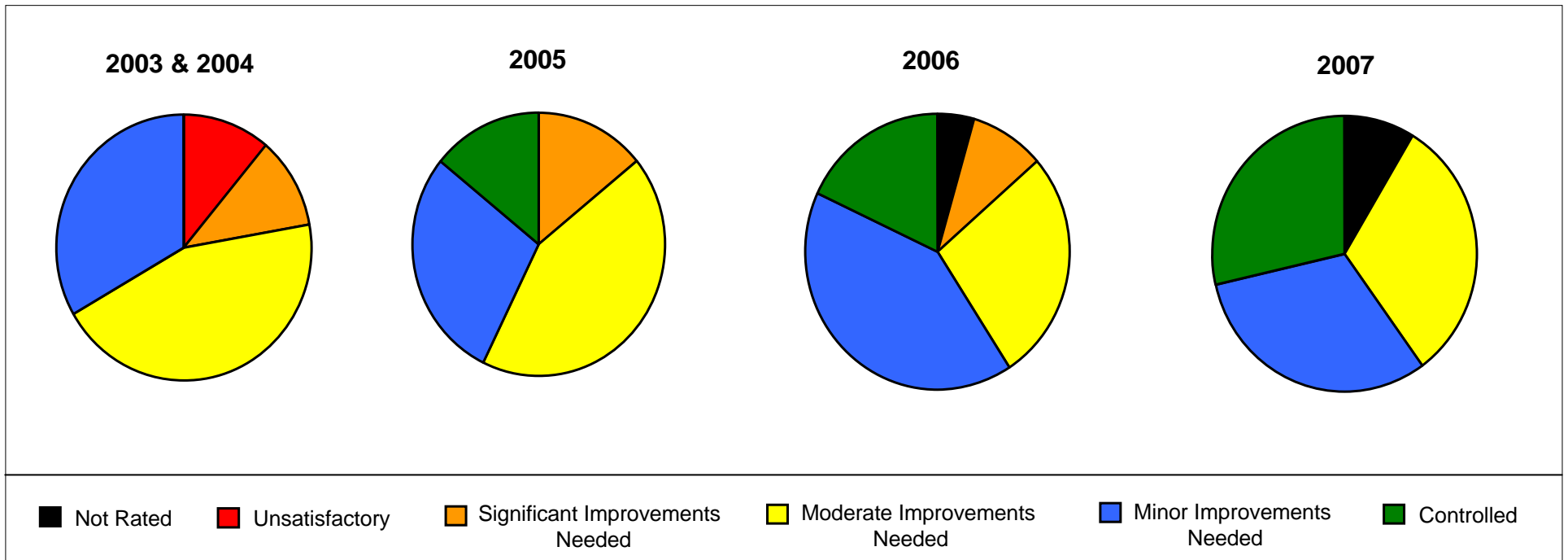
# Audit Update

# Internal Audit Coverage



- Absolute number of audits is stabilizing ~35
- Comprehensive audit program with coverage of the entire organization

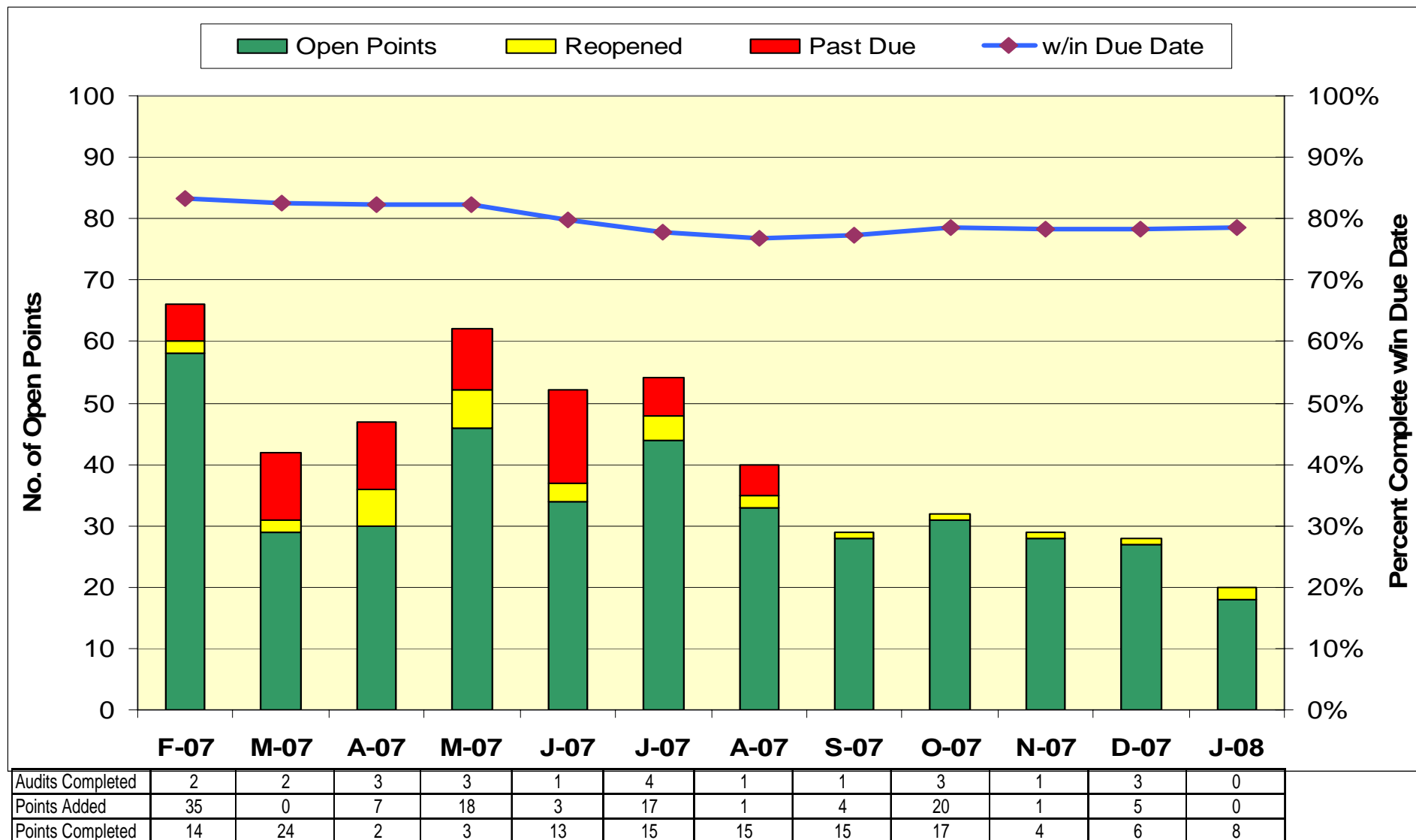
# Audit Results - Ratings



- Improved from 33% with “Minor Improvement” or better ratings in 2003/04 to 60% in 2007
- No unsatisfactory ratings in 2005, 2006 or 2007

- IBM – Review of Nodal Program controls
- Financial
  - Annual Financial Statement - Unqualified
  - SAS 70 Type II - Unqualified
  - Money Purchase Plan and 401k Plan Audit
    - Disclaimer of Opinion – as expected
- Security and other reviews
- NERC and FERC
- Internal Control Management Program (ICMP)
  - Maintenance of control environment
  - Ongoing monitoring of audit findings and remediation plans

# Audit Findings and Remediation Status



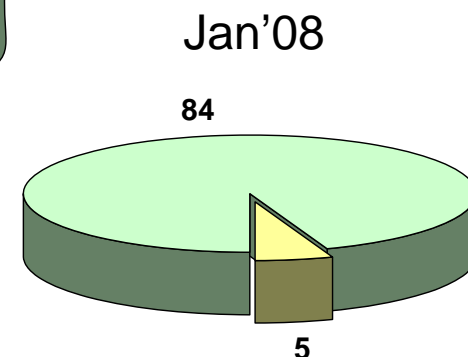
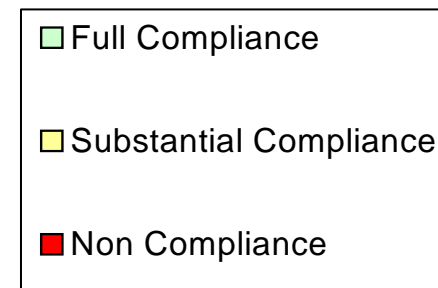
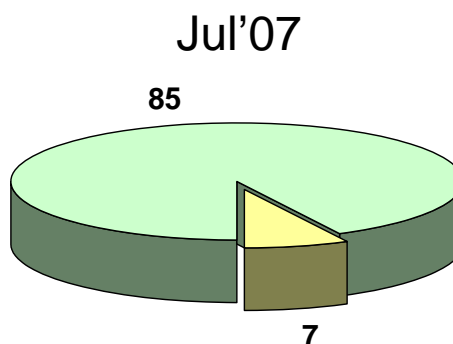
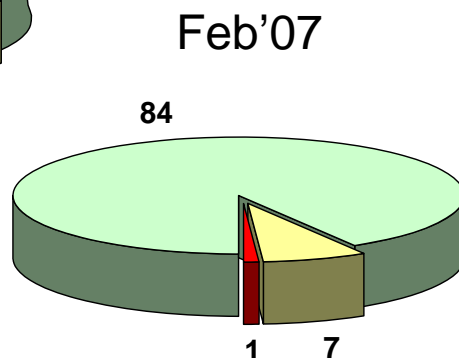
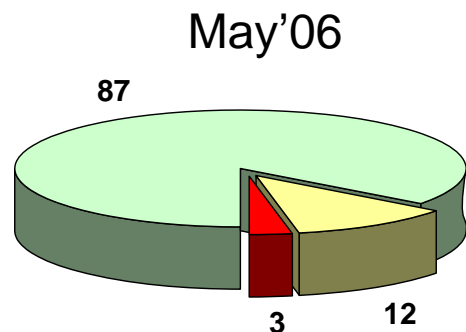
# Compliance Update

# Management Compliance “Self Assessment”

- Management conducts regular “self assessments” of compliance
  - Applicable laws
  - Regulations & protocols
  - Contractual obligations
  - Disclosure mandates
  - Etc.
- For each requirement, an assessment is made of whether the area is in Full Compliance, Substantial Compliance, or Non Compliance. Any areas not in Full Compliance require further explanation.
- Each ERCOT Officer has completed signed attestations as to the status of Compliance Requirements within their respective organizations as of January 15, 2008.
- ERCOT is facing significant increases in compliance requirements
  - Reliability matters
  - Governance



# Management Compliance – Status

































- We are presently tracking 89 compliance items with 100% reported as “Substantial Compliance” or better
- Details regarding changes to compliance status since last Board report (September 2007) are included in your Executive Session materials.

# Enterprise Risk Management Update

- **Drill down with Finance and Audit in October 2007**
  - Detailed discussions on risk matrix and accountability
  - Realistic and actionable mitigation plans
- **Continue with basic structure and reporting**
- **Additional reporting capability under development**

# February 2008 Risk Inventory "Stoplight" Report

## ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC. RISK MANAGEMENT EVENT PROFILE MATRIX (as of February 1st, 2008)

 <b>Strategic Risks</b>	 <b>Operational Excellence</b>	 <b>Market Facilitation</b>	 <b>Grid Reliability</b>	 <b>Reporting Risk</b>	 <b>Legal and Regulatory Compliance Risks</b>
 <b>Strategy Development</b> Corporate objective setting adequately incorporates informed stakeholder input, market realities and management expertise.  Current planning effort only at tactical level (5-10 years). Risk assessment and business planning horizon needs to be extended. Development of a strategic plan is underway. Preliminary version of plan shared with TAC in January. Expect to present to Board during Q1'08.	 <b>Performance Monitoring</b> Clearly defined and actively monitored performance metrics linked to mission and goals. Performance status communicated and corrective action taken.	 <b>Customer Choice</b> ↓ Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired.	 <b>Grid Operations</b> ↓ Information required to operate the grid is efficiently gathered. Appropriate tools are prudently configured to efficiently operate the system.	 <b>Review Practices</b> Prudent measures are taken to insure that company disclosures are properly vetted and not misleading.	 <b>Legal &amp; Legislative</b> Operations are conducted in compliance with all laws and regulations. Impacts of current and proposed legislation are understood and communicated.
 <b>Mission and Goals</b> Corporate objectives and performance standards are understood and followed.	 <b>Business Practices</b> Business planning, processes and management standards are effective and efficient.	 <b>Nodal Implementation Project</b> Nodal Implementation on budget on schedule, and within defined scope.	 <b>Planning</b> Long-range planning methods enable efficient responses to system changes that are necessary to maintain reliability standards.	 <b>Disclosure</b> Reporting and other disclosures to intended parties is timely, accurate and effective.	 <b>Internal Control Compliance</b> Internal Control Compliance, processes and management standards are effective and efficient.
	Disaster recovery plans are currently below desired expectations. Business Continuity Plan coordinator has been selected. Gap analysis complete. Business Impact Assessments (BIA's) complete. Working off BIA's, IT is developing recommendations to either close gaps identified or accept limited risks until nodal moved to production. Business Continuity Plan revisions to be completed in February. Disaster Recovery Plan revisions beginning in February. BCP training to be conducted in February and testing to be conducted in March.	Scope and schedule remain unchanged (green and amber respectively). Budget risk has increased to red. Major milestones have been reached to date. Many base systems have been delivered. Baseline 1 and 2 systems are in various delivery phases. Quality tracking has improved and metrics show varying degrees of quality across all projects. Critical items yet to be resolved include implementation of integrated testing environment (January) and resolution of common information model (CIM) importer problems.	The December update to the 2007 ERCOT Five Year plan shows higher reserve margins in the near term due to an improvement in generation outlook. The CREZ Transmission Optimization (CTO) Study and the surge of generation interconnection requests in the five-year horizon are tying up all available resources in System Planning, but the completion of the CTO study in April will allow staff to start work on the 2008 Long Term System Assessment.		The Internal Control department (ICMP) has developed an initial plan for business process training for certain areas. ICMP is working with the business process owners and HR to set up company-wide training for delivery in 2008.
 <b>Reputation</b> ↑ Positive perceptions by stakeholders lead to less cost and greater flexibility resulting in enhanced enterprise value.	 <b>Workforce</b> Organization design, managerial and technical skills, bench strength and reward systems aligned with corporate goals.	 <b>Counterparty Credit</b> Maintain credit risk exposure for overall market within acceptable limits.	 <b>Bulk System Resources</b> ↓ Market Participants construct and make available adequate bulk electric grid resources.	 <b>Communication</b> Internal & external communications are timely and effective.	 <b>Industry Standards</b> Business practices provide stakeholders with required assurances of quality.
Increased publicity associated with the implementation of the Nodal market and anticipated new fee filings for the nodal surcharge and System Administration fee have the potential to negatively impact ERCOT's reputation.	ERCOT continues to face an increased demand for the skill sets of employees. Open positions increased to 70 in January. Seasonal reduction in open positions or terminations normally seen in previous years is not occurring. We are interviewing and locating a large number of excellent candidates and expect many new hires in February and March. Expect turnover to increase this year as market participants prepare for nodal implementation and solicit our talent. College recruiting has produced excellent results and we expect our new internship program to provide hiring resources for the future. Continuing to review additional options to retain talent.	ERCOT is developing enhanced metrics to measure the residual credit risk assumed by market participants. ERCOT previewed results with the CWG in January and with the F&A committee in early February. Final results are expected to be discussed with the Board in February 2008. A determination of the acceptable level of residual credit risk exposure will be made by the ERCOT Board of Directors.	Preparation for the ERCOT Long Term System Assessment (due in Jun'08) will begin in the first quarter of 2008. ERCOT is developing new transmission interconnection solutions for new proposed power plants included in the new CDR update. Two new generation interconnection agreements have been signed since the December 2007 CDR update and will bring reserves above 12.5% through 2010.		Initiation of ERO/TRE reliability standard Compliance Monitoring and Regional Entity Compliance Program in June introduces additional audit and penalty risks which ERCOT is still assessing. Issues raised to date by the Texas RE have been addressed / corrected. ERCOT received an unqualified SAS70 audit report in December.
 <b>Fiscal Management</b> ISO design requires competent, prudent and cost effective provision of services.	 <b>Technology Infrastructure</b> Information systems, supporting facilities and data are effectively managed and are reliable.	 <b>Administration, Settlement &amp; Billing</b> Market rules fairly applied to all participants. Accounting is timely and accurately reflects electricity production and delivery.	 <b>Operational Responsibility</b> Market participant conduct their operations in a manner which facilitates consistent grid reliability.	 <b>Adequacy and Integrity</b> Robust processes exist to support management assertions embodied within financial reports.	 <b>Regulatory Filings</b> Evidence, testimony and other supporting materials are compelling and successful.
	SAIC has completed the review of the retail systems. Several recommendations have been suggested and will be considered for future implementation. The AIX migrations continue on schedule. Most production systems have been moved to AIX and system stabilization has gone well. Wholesale system processing slowdowns have been addressed and infrastructure design changes will be implemented after January 1, 2008. Aging hardware is becoming a concern. Projects to replace older servers have been initiated while other hardware will be replaced by the Nodal project.	AIX processing delays have been resolved and processing has returned to pre-migration levels. However, database backup and production failover processes in case of emergencies is on hold until infrastructure changes stabilize (see Customer Choice above).	Response of generators and LaaRs to grid operation events has been improving. Enhanced enforcement of NERC standards and ERCOT Protocols and Operating Guides will exist through the ERO / TRE and IMM which will provide additional incentive for improved performance. Increased wind generation will present additional operational challenges that are currently being defined in a special study which should be completed in the first quarter of 2008.		Nodal Implementation and System Admin Fee rate case applications will be filed with PUCT in 2008.

# Questions

## *Appendix*

# Appendix - Compliance Definitions

- **Full Compliance**

The compliance standard fully meets the laws, regulations, policies, procedures and/or practices as written. All elements or requirements are evident in practice with extremely rare or no exceptions. Exceptions in compliance do not affect, in any way, consistency with the aims of the laws, regulations, policies, procedures and/or practices, the organizational performance or the quality of service.

- **Substantial Compliance**

The compliance standard's essential requirements are met, but one or more factors are missing or need augmentation. Appropriate policies and procedures are in place. Minor inconsistencies, deviations and/or underdeveloped practices are noted; however, such inconsistencies or deviations do not jeopardize persons served, overall performance, or consistency with the aims of the laws, regulations, policies, procedures and/or practices or the organization in any way. An action plan has been developed and implemented to achieve Full Compliance within a reasonable amount of time.

- **Non Compliance**

Practice or documentation does not address, or is in opposition to, the compliance standard's requirements. Few, if any, of the compliance standard's requirements are met. The organization does not have many of the necessary components of the basic framework the compliance standard requires. Organizational functioning or integrity may be compromised. Health and safety of persons served may be at risk. The organization demonstrates inconsistency with the aims of the laws, regulations, policies, procedures and/or practices. An action plan has been developed and implemented to achieve Substantial Compliance in an expedited manner.