



Review of Internal Controls

ERCOT Board of Directors

15 July 2008

Steve Byone

Vice President and Chief Financial Officer

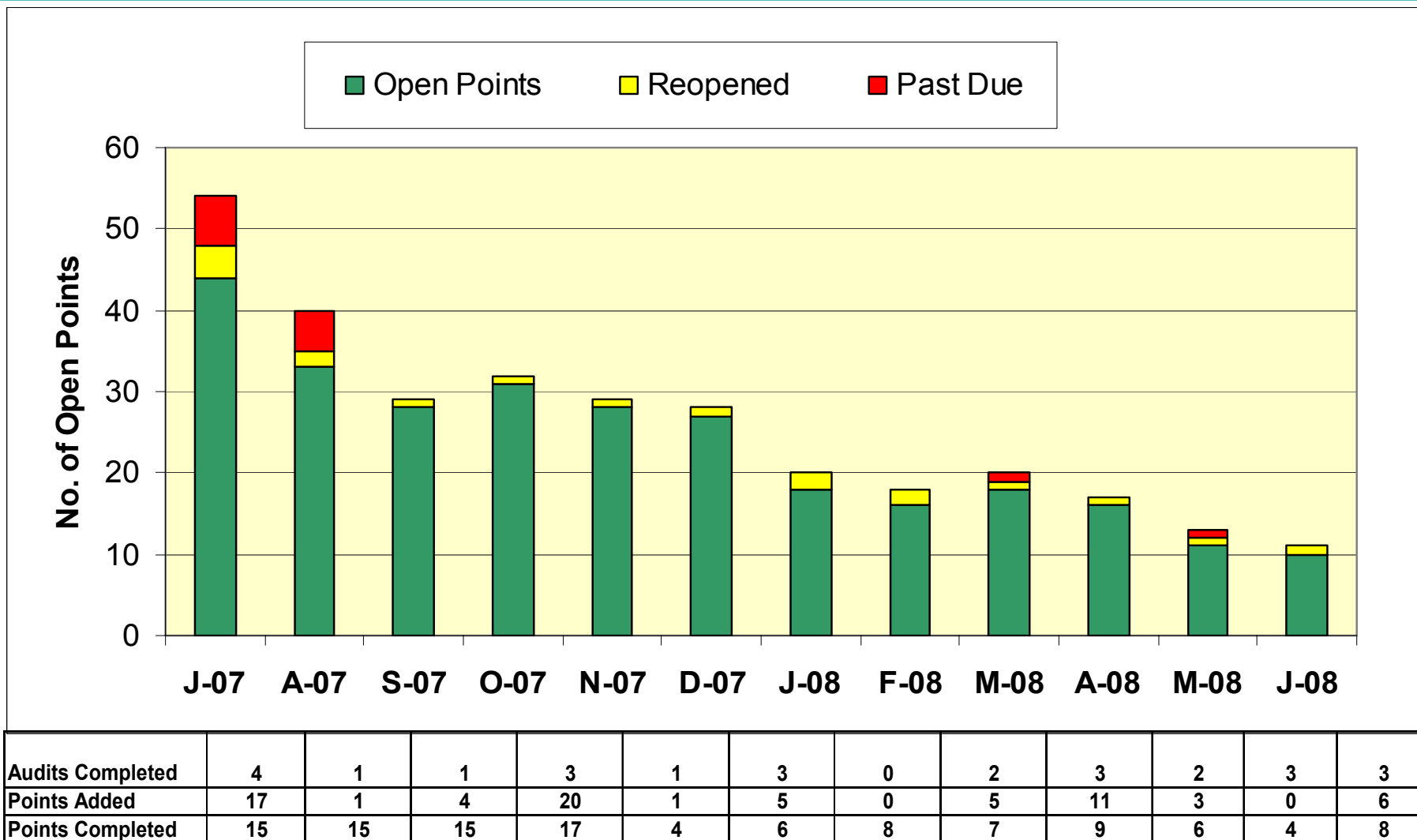
- **Internal Control Management Program (ICMP) is ERCOT's SOX compliance program (voluntary)**
- **ControlPath Compliance system enables routine management monitoring of control effectiveness**
- **Policies and procedures are reviewed and updated as needed**
- **Changes to policies/procedures are periodically communicated to all ERCOT staff and contract workers**
- **The Internal Audit function has reached maturity and is directed by Finance & Audit**

Adequate tools are in place to maintain a controlled environment

- **ControlPath Compliance system implemented**
 - Includes general financial controls and SAS70
 - Control Objectives – 345
 - Control Activities – 840
 - Y-T-D 100 ICMP Control Self Assessment Questionnaires Issued
 - 81% of responses received to date
 - Responses indicate: 97% - Fully Met
 - 2% - Partially Met (Follow-up underway)
 - 1% - Not Met (Follow-up underway)
- **Policy/Procedure updates - 100 to date**
- **Training development/implementation continues**
 - Using Learning Management System (web-based tool) to deploy training across the organization

- **2007 Financial Audit completed by PwC in April → Unqualified opinion**
- **2008 SAS70 Audit is in process**
 - First round of testing performed in April and May → no exceptions so far
- **2008 401K Audit scheduled to begin in July**
 - Audit to be performed by Maxwell, Locke & Ritter
- **Internal Audit on track to complete Audit Plan for 2008**
 - 8 Audits completed to date
 - Also performing audits/reviews based on special requests
- **2 Security Assessments planned in the next 3 months**
 - 1 assessment will be performed on Nodal systems
- **YTD 14 audit reports received with 25 audit points**

Status of Open Audit Points



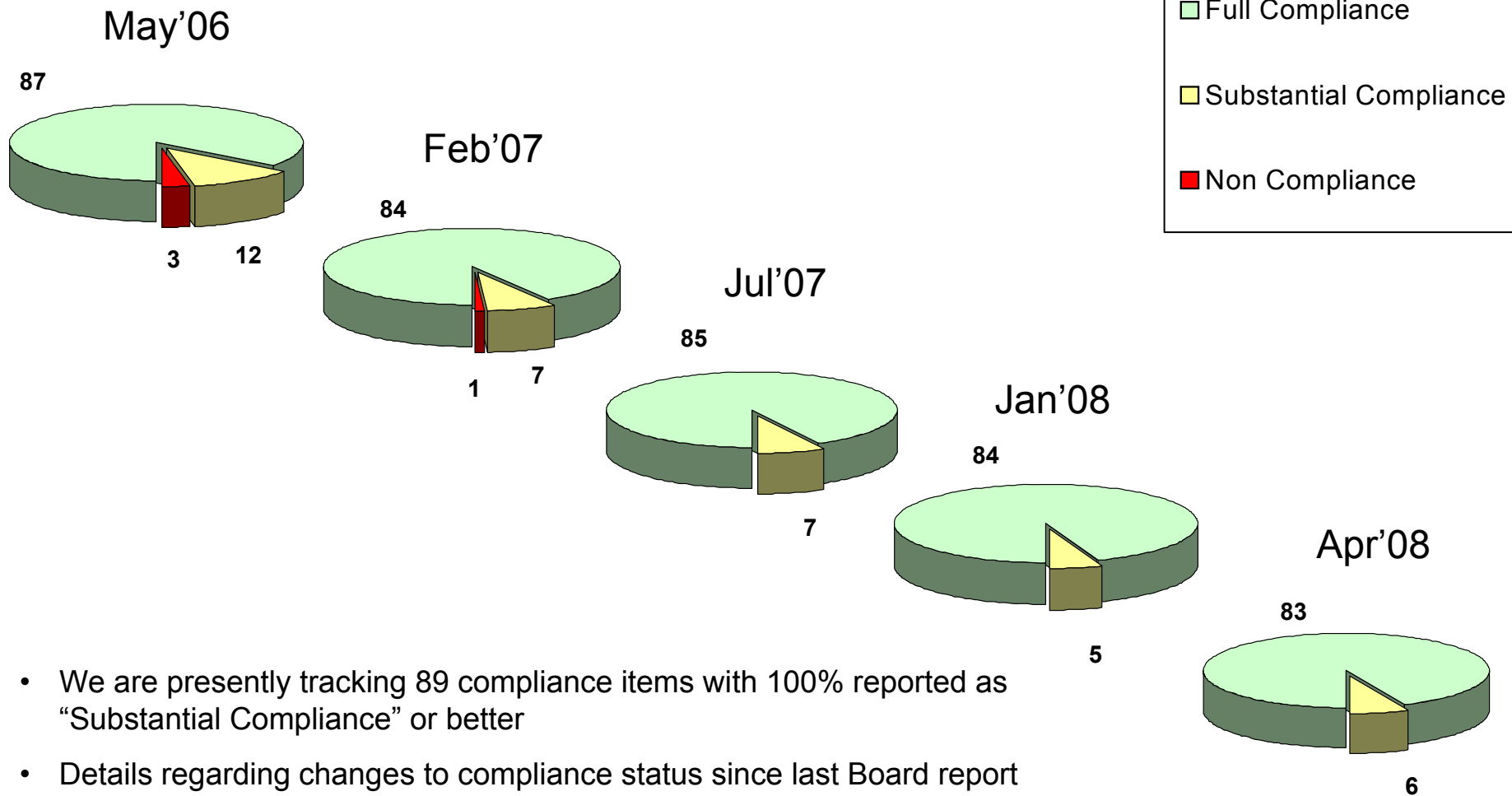
Open audit points projected to be complete by March 31, 2009.

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 for January 15, 2008 to April 15, 2008. (June underway)
- ERCOT is facing significant increases in compliance requirements
 - Reliability matters
 - Governance































Management Compliance – Status Update



- 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 (February 2008) are included in your Executive Session materials.

July 2008 Risk Inventory "Stoplight" Report

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

 Strategic	 Operational Excellence	 Market Facilitation	 Grid Reliability	 Reporting	 Legal and Regulatory Compliance
 Strategy Development Corporate objective setting adequately incorporates informed stakeholder input, market realities and management expertise.	 Performance Monitoring Clearly defined and actively monitored performance metrics linked to mission and goals - Performance status communicated and corrective action taken.	 Customer Choice Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired. We currently manage disaster recovery events on a case-by-case basis and will continue to do so to meet stakeholder expectations for accurate and timely processing. A detailed disaster recovery plan with processes and procedures was completed as part of the Business Continuity project. System testing is currently scheduled to be done after nodal implementation.	 Grid Operations Information required to operate the grid is efficiently gathered. Appropriate tools are prudently configured to efficiently operate the system.	 Review Practices Prudent measures are taken to insure that company disclosures are properly vetted and not misleading.	 Legal & Legislative Operations are conducted in compliance with all laws and regulations. Impacts of current and proposed legislation are understood and communicated.
 Mission and Goals Corporate objectives and performance standards are understood and followed. New Strategic Plan needs to be integrated into the latest business planning cycle.	 Business Practices Business planning, processes and management standards are effective and efficient. Revisions to Business Continuity, Emergency Response and Pandemic Preparedness plans completed, approved and tested. DR plans and testing (table top only) completed for commercial/corporate applications except Exchange and Citrix which have a plan but have not been tested. Efforts now focused on adding nodal systems to BC/DR Plans to coincide with the start of the 168-hr test.	 Nodal Implementation Project Nodal implementation on budget on schedule, and within defined scope. Delays in the delivery of Common Information Model (CIM) will delay the start of the 168-hour test, making it unlikely we will meet the December 1 go-live date. The new schedule is under development and will not be completed until August or September. The Common Information Model importer has not yet been delivered and the new schedule will not be revealed until that module is complete. A revised budget is also under development and will be posted during Q3. A successful test of real-time and load frequency control was completed. The first live CRR auction has been completed.	 Planning Long-range planning methods enable efficient responses to system changes that are necessary to maintain reliability standards. Due to high number of vacancies in engineering positions, the ongoing requirements of the CREZ Transmission Optimization (CTO) Study and the continued higher than normal volume of generation interconnection requests in the five-year horizon, the Long Term System Assessment (LTSA) work has not started. We expect to start the LTSA study following the conclusion of the support for the CREZ case at the PUCT.	 Disclosure Reporting and other disclosures to intended parties is timely, accurate and effective.	 Internal Control Compliance Internal Control Compliance, processes and management standards are effective and efficient. The controls covered by ICMP and the SAS70 have been loaded into ControlPath Compliance system. ICMP Control Self Assessment Questionnaires have been issued for Q2. Policies/procedures are reviewed/updated annually. Changes to policies/procedures are periodically communicated to all ERCOT staff and contract workers. Adequate tools are in place to maintain a controlled environment.
 Reputation Positive perceptions by stakeholders lead to less cost and greater flexibility resulting in enhanced enterprise value. Increased publicity associated with the delay of the Nodal market and the potential for associated cost increases, anticipated new fee filings for the nodal surcharge and System Administration fee, high congestion, high price volatility and recent credit defaults have the potential to negatively impact ERCOT's reputation.	 Workforce Organization design, managerial and technical skills, bench strength and reward systems aligned with corporate goals. ERCOT continues to face a tight demand for the skill sets of many of our employees. We continue to be "amber" for ERCOT readiness; however, the benchmark of 98% staffed for nodal critical positions is a tough target for July and the months following before Nodal go-live. June is typically a strong hiring month. We continue to expect turnover to be a concern this year as market participants prepare for nodal implementation.	 Counterparty Credit Maintain credit risk exposure for overall market within acceptable limits. A draft credit risk standard has been circulated and is being reviewed with stakeholders. A proposal is expected to be submitted to F&A in October or November. Several QSEs have failed to provide collateral and five have been removed from the market. Processes that were implemented in mid-2006 to switch customers from defaulting QSEs in 3-4 business days were successfully implemented. There is an increased risk of additional defaults by market participants if energy price volatility remains high.	 Bulk System Resources Market Participants construct and make available adequate bulk electric grid resources.	 Communication Internal & external communications are timely and effective.	 Industry Standards Business practices provide stakeholders with required assurances of quality. 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. Although current decentralized compliance activities are adequate, ERCOT is in the process of centralizing the compliance function to provide more focus on these issues.
 Fiscal Management ISO design requires competent, prudent and cost effective provision of services.	 Technology Infrastructure Information systems, supporting facilities and data are effectively managed and are reliable. Infrastructure environment has been stable since the move to the new IBM (AIX) equipment. Performance has been at or above expectations in most areas. Reliability has been outstanding. Data Center constraints still exist and will be tight until Taylor Data Center expansion and replacement of Met Data Center is complete. Storage requirements continue to grow at a very high rate. An outside review of data storage is expected to start in July.	 Administration, Settlement & Billing Market rules fairly applied to all participants. Accounting is timely and accurately reflects electricity production and delivery. We currently manage disaster recovery events on a case-by-case basis and will continue to do so to meet stakeholder expectations for accurate and timely processing. A detailed disaster recovery plan with processes and procedures was completed as part of the Business Continuity project. System testing is currently scheduled to be done after nodal implementation.	 Operational Responsibility Market participant conduct their operations in a manner which facilitates consistent grid reliability. 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 a study indicated can be met. A joint ERCOT Staff and Market Participant Wind Operations Task Force is addressing several operational issues regarding wind generation and is making recommendations on changes to more reliably integrate wind generation.	 Adequacy and Integrity Robust processes exist to support management assertions embodied within financial reports.	 Regulatory Filings Evidence, testimony and other supporting materials are compelling and successful. System Admin Fee rate case application was filed with the PUCT on June 17.

Legend:  Elevated Risk Level

 Reduced Risk Level

(New Risk Categories / Descriptions Indicated in Green)

- **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.