



ERCOT Finance & Audit Committee Meeting

ERCOT

7620 Metro Center Drive, Austin, Texas

Room 168

July 18, 2006; 8:00 a.m. - 10:00 a.m.**

Agenda Item #	Description/Purpose/Action Required	Presenter	Time
	Call to Order	C Karnei	8:00 a.m.
1.	Approval of Minutes* (Vote) (06/20/06)	C Karnei	8:00 a.m.
2.	Election of Vice-Chair (Vote)	C Karnei	8:05 a.m.
3.	SAS 70 Audit Plan	S Barry	8:10 a.m.
4.	CWG Proposals	M Davies	8:20 a.m.
5.	2007 Budget Preview	M Petterson	8:40 a.m.
6.	Nodal Financing/Liquidity Planning	C Yager	8:55 a.m.
7.	Internal Control Audit Update (D&T Preliminary Feedback)	C Moseley	9:05 a.m.
8.	SAS 70 Update/2005 Remediation Status	A Delenela / S Barry	9:10 a.m.
9.	Committee Briefs	All	9:20 a.m.
	<ul style="list-style-type: none"> • Credit Stats • Quarterly Investment Results 	C Yager	
10.	Future Agenda Items/Other Topics	S Byone	9:25 a.m.
11.	Adjourn to Executive Session		9:30 a.m.
	<ul style="list-style-type: none"> • Update on Internal Audit Staffing 	B Wullenjohn	9:30 a.m.
	<ul style="list-style-type: none"> • Significant Audit Findings 	C Vance	9:35 a.m.
	<ul style="list-style-type: none"> • Ethics Point 	C Vance	9:50 a.m.
	Adjourn		9:55 a.m.

*** Background material enclosed or will be distributed prior to meeting. All times shown in the Agenda are approximate
The next FA Committee Meeting will be held August 15, at ERCOT, 7620 Metro Center Drive, Austin, Texas.*

Draft MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center
8:00 A.M.
June 20, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at approximately 8:02 A.M. on **June 20, 2006**. The Meeting was called to order by **Darrell Hayslip** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Not Present
Darrell Hayslip, <i>Vice Chair, Acting 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
John Houston for Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present

ERCOT staff and guests present:

Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Delenela, Ann	ERCOT
Doolin, Estrellita	ERCOT
Jones, Sam	ERCOT (CEO)
Kolodziej, Eddie	Customized Energy Solutions
Lanford, Lane	PUC (Executive Director)
McElfresh, Brandon	ERCOT
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Paula	PUC (Deputy Executive Director)
Petterson, Mike	ERCOT
Roark, Dottie	ERCOT
Taylor, William	Calpine
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wullenjohn, William	ERCOT (via telephone)
Yager, Cheryl	ERCOT

Approval of Previous Minutes

Miguel Espinosa moved to approve the minutes for the previous meeting held on **May 16, 2006**; **Scott Gahn** seconded the motion. The motion passed unanimously.

Review 2005 Financial Audit Recommendations

Mike Petterson provided an overview of the PricewaterhouseCoopers (PwC) report that was distributed to the Committee on May 16, 2006 and was included with the Board meeting materials for June 20, 2006. Mr. Petterson noted that the report identified one significant deficiency regarding year-end accruals and cut-off; however, the identified issues had no significant net effect on the 2005 financial statements. Mr. Petterson explained that the report also noted three other less significant deficiencies: preparation, review, and approval of journal entries (for which ERCOT had already made adjustments); accounting for the interest rate swap; and preparation, review, and retention of period end account reconciliations. Mr. Petterson confirmed to the Committee that, as described in the report, all deficiencies were cleared before the June 30, 2006 month-end close.

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Miguel Espinosa asked if staff was comfortable that all issues had been resolved. Mr. Petterson confirmed that, although there was always room for improvement in any organization, all issues had been resolved.

Mr. Petterson notified the Committee that staff would, in the near future, like to present material and seek guidance from the Committee members on the threshold of "materiality" relative to ERCOT's financial statements and decisions made by users of the financial information, and the threshold for transactions deemed "consequential" or "material." Mr. Petterson noted that identifying the agreed upon levels would be helpful to staff as well as PwC auditors in future audits.

Procedures for Handling the Reporting of Violations

Cathy Vance informed the Committee that during the annual mandatory antitrust training of ERCOT employees in the spring by the Legal Department, she had conducted fraud prevention training. Ms. Vance explained that this training had included a discussion of the mechanisms for the reporting of complaints to ensure that employees were aware of their many options. Ms. Vance also notified the Committee that ERCOT was preparing for its annual ethics reaffirmation process for employees. She explained that ethics training would be completed in this process through PowerPoint presentation materials sent to each employee. After reviewing the training materials, employees will be required to execute a reaffirmation of their Ethics Agreement within three to five days.

Review External Auditor Service Pre-approval Status

Mike Petterson reminded the Committee that the Committee Charter requires the Committee to pre-approve all non-audit services provided by ERCOT's independent auditor (PwC), with exception for nominal items which may be approved after the fact. Mr. Petterson notified the Committee that PwC provides only one non-audit service to ERCOT, which is a subscription (<\$5,000) to an accounting research and reference database application, which was pre-approved by the Committee in November 2005.

Review and approve ERCOT annual report

Dottie Roark reviewed the ERCOT annual report with the Committee, answered questions and requested approval of the annual report.

Miguel Espinosa moved to approve for release the annual report; Bob Manning seconded the motion. The motion passed.

Committee Briefs

Risk Stop Light Report Update

Don Meek reviewed the changes on the Risk Management Event Profile Matrix ("Stop Light Report") with the Committee. Mr. Meek noted that there had been a reduction in risk in Counterparty Credit due to adopted PRRs and Communications due to internal activities, including the finalization of documentation of a Crisis Communication Plan. Mr. Meek also stated that ERCOT has 'stabilized' risk measures after April EECF event. Mr. Meek noted that there was an increase in Internal Control Compliance Risk due to staff turnover and lack of training, and that Human Resources and Nodal Implementation still required 'special attention' due to excessive risk levels.

Credit Update

Cheryl Yager provided a brief overview of the credit update materials provided to the members, including the average weekly pricing. Ms. Yager explained the benefit of the timeline-shortening PRRs that had recently passed by estimating the savings to the market in 2005 if the new PRRs had already been in place. Ms. Yager confirmed that the Credit Work Group continues to work on long term credit solutions.

Plan for PUCT involvement in 2007 Budget Preparation

Darrell Hayslip explained that Lane Lanford, Executive Director of the Public Utility Commission ("PUC"), and Paula Mueller, Deputy Executive Director of the PUC, had come to discuss PUC involvement in the 2007 Budget preparation with the Committee. Mr. Lanford and Ms. Mueller explained that, because of the nature of the fee case (contested case requiring notice and opportunity for parties to object); it could not be conducted with the collaborative process requested by the Committee. Ms. Mueller explained that the staff must follow certain processes in preparing the case and the Commissioners must make their fee decision based upon the evidence in the fee case record. Mr. Lanford and Ms. Mueller confirmed that the ERCOT fee process is different from the rate process used for regulated utilities and may need to be conducted more like the PUC budget process.

Mr. Lanford suggested that it might be possible to conduct the fee case process in pieces, with early hearings on certain of the important or controversial concepts, such as debt financing and projects. Darrell Hayslip noted that the Committee was looking for alignment of philosophy with the PUC, so that ERCOT could work on the items that were of importance to the PUC. Mr. Lanford suggested that the process might be broken into several phases, with open hearings during each phase. Mr. Lanford proposed that the categories of the budget could be discussed in the first phase of the process and the amount proposed by ERCOT for each budget category could be determined in the second phase of the process. ERCOT would then get to hear from the Commissioners regarding any "hot button" topics before it finalized the proposed budget, and both parties would better understand which issues would likely be controversial.

Ms. Mueller suggested that the ERCOT budget development process and fee approval process would always be separate—even if inefficient—and cited the following items as likely to be of

interest to the commissioners: 1) compensation levels, 2) use of contract labor, 3) debt financing, 4) projects, and 5) other.

Mr. Espinosa stated that ERCOT would like a smoother process and would like to know, early in the process, what additional information was sought by the PUC. Mr. Espinosa cited an example of the compensation study which had been criticized by Commissioner Smitherman, because it did not include information from other ISOs. However, the reason the study didn't contain ISO data was because of a requirement by PUC staff or a different Commissioner. Mr. Lanford stated that it was never a good idea for ERCOT to act upon the direction of one Commissioner, since it took at least two Commissioners to approve a ruling Mr. Hayslip stated that the Committee was pleased that the ERCOT budgeting process was getting better each year and that ERCOT would continue its efforts to improve communication with the PUC to align philosophies regarding the budget and fee.

Nodal Funding Update

Cheryl Yager reviewed the status of the Nodal Surcharge filing. Ms. Yager confirmed that ERCOT had filed a request to begin recovery of an interim surcharge to begin funding the Nodal Market Redesign project at the rate of \$.0663, and that no settlement had been reached. Ms. Yager informed the Committee that the hearing on the Nodal Surcharge was set for July 21, 2006. Ms. Yager explained that the spending needs for Nodal will drive ERCOT's need to increase available liquidity to remain compliant with ERCOT Financial policy, and that staff is currently refining forecast of amount of liquidity required to fund the Nodal project. Ms. Yager indicated that staff would present various options for the Committee's consideration during the 3rd quarter.

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Future Agenda Items and Other Topics

Steve Byone informed the Committee that ERCOT needed request authorization from the PUC for a "Special Fee" to enable ERCOT to bill Entergy for costs incurred in connection with the interconnection study requested by the Commission. Mr. Byone confirmed that ERCOT is incurring costs to conduct the study but is not currently authorized to seek reimbursement for the work directed by the Commission. Accordingly, ERCOT expects to prepare a filing for the Special Fee in the next few weeks. Mr. Byone stated that staff had informed him that they expected to expend less than \$100,000 on the study.

Mr. Byone informed the Committee that the prioritization of projects in TAC was on schedule. Mr. Espinosa stated that the constant of \$25 million did seem suspect and would like to determine how best to approach the project budgeting.

Adjournment

At approximately 9:10 A.M., the meeting was adjourned and the Committee went into Executive Session. The next regularly scheduled meeting will be held on the morning of July 18, 2006.

Susan Vincent, Secretary

Election of Vice-Chair (Vote)

Clifton Karnei

**ERCOT, Inc.
2006 SAS #70
Scope and Engagement Plan
Finance & Audit Committee
July 18, 2006**

Agenda

- Overview
- Project Scope
- Higher Risk Areas
- Timeline
- Status

Overview

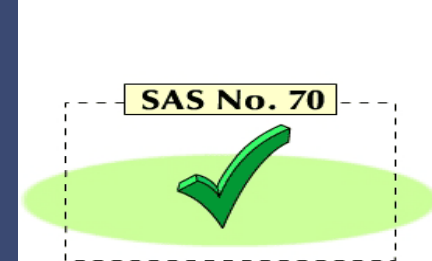
- SAS 70 is an examination of Internal Controls
- ERCOT has been the subject of numerous internal control audits
- SAS 70 Scope fits in this way:
 - Covers market activities – not internal accounting (fee matters)
 - Primarily for benefit of market participants and their auditors
 - Recurring in nature – not a one time project (like some ERCOT controls audits)
 - Covers an specific period of time

Why Do Organizations Produce SAS No. 70 Reports?



- Primarily - to communicate necessary controls information and independent assurance to customers (market participants) relating to transactions processed by the service provider (ERCOT).
 - Independent or Financial Auditors of a user organization
 - Internal Audit department of a user organization
 - Sarbanes Oxley Section 404 compliance.
- Secondly - for internal purposes
 - management – internal control and fiduciary responsibilities to market
 - Board/ Audit Committee - oversight/ governance

Now We Know How It Is Used, But What Does “SAS No. 70” Mean, and do I care about the other 69 SASs?



Statements On Auditing Standards Number 70 *Reports on the Processing of Transactions by Service Organizations*

- Also known as a “Third-party Comfort Report”
- Standards documented by the American Institute of Certified Public Accountants (AICPA)

ERCOT SAS 70 History

- 2002 – Type I report issued.
- 2003 – Internal diagnostic only – no external report
- 2004 – Type II report covering period May 1, 2004 through October 31, 2004
- 2005 – Type II report covering period April 1, 2005 through September 31, 2005

Scope of SAS 70

- Scope comprises 18 total control objectives
 - Similar to Scope of 2005 SAS 70
 - 13 business processes
 - 5 information systems
- Functions and processes covered:
 - Business processes and general controls that impact or affect financial wholesale market settlement
 - Processes that are otherwise “invisible” to the members and upon which they must rely on ERCOT for controls

Areas of Emphasis

Exceptions noted in prior year's SAS 70 Report

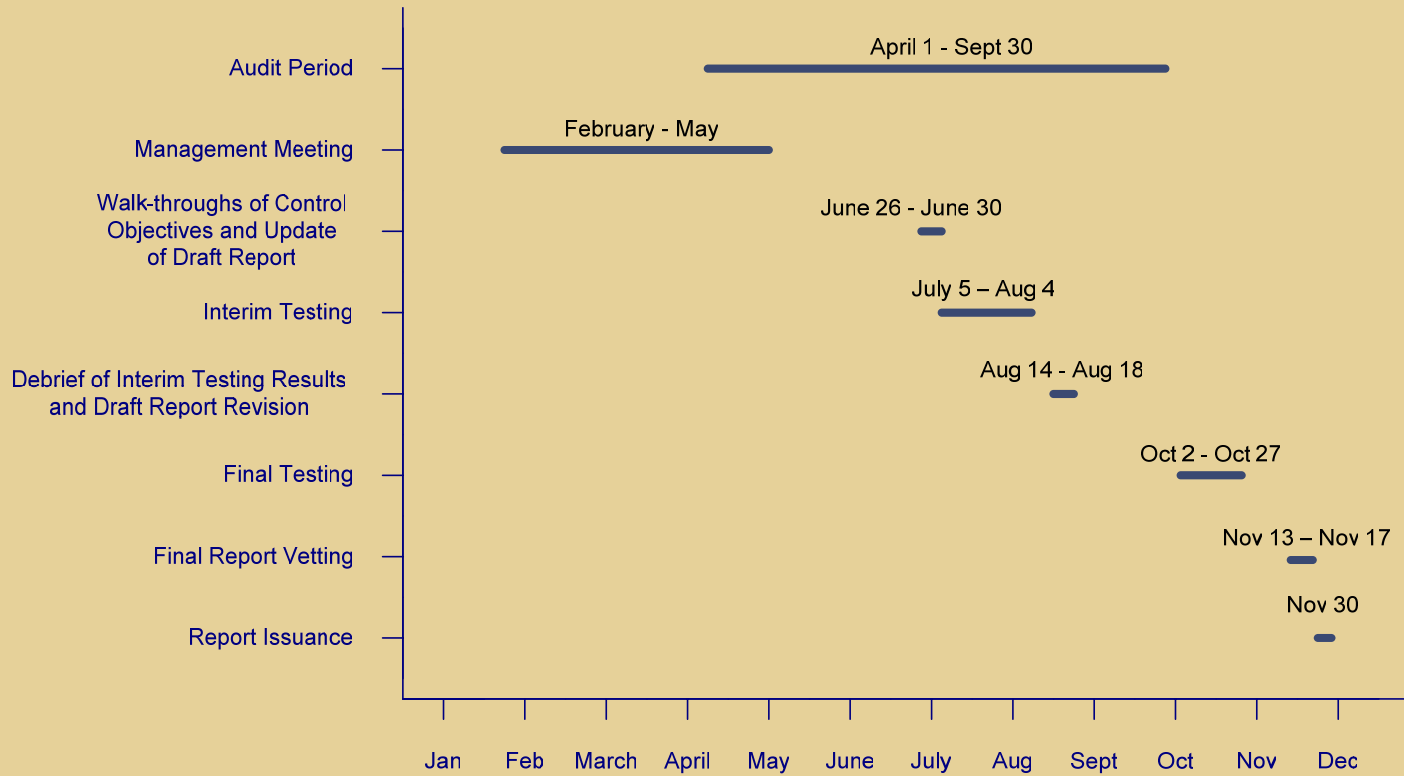
- Controls over the monitoring of logical (IT) security
- Controls over granting of access and subsequent monitoring of access to sensitive facilities

Higher risk area for most ISOs/RTOs – Controls over change management - particularly software emergency changes

Changes to Protocols since the last audit

Changes in Key Personnel and responsibilities

Timeline Overview



Current Status

- **Walk-throughs were conducted in June for all areas**
- **Pre-assessment of IT Security recertification – not complete**
- **Process documentation for SAS 70 report has been revised**
- **Control objectives and test plans have been prepared for all areas**
- **Interim testing commenced July 5th – expected completion by August 4th**

July Credit Update

- **To meet the F&A Committee’s request that the Credit WG develop options for dealing with residual credit exposure, Credit WG met in Austin on June 23**
 - At its May 2006 meeting, F&A requested that Credit WG present the “book end” options for addressing remaining credit exposure as well as areas of consensus in the group
- **Credit WG members agree that a great deal has been accomplished over the past year to improve the credit profile**
 - Discussion centered around what to do with remaining credit exposure

Market Improvements to date

- Current solution reduces Mass Transition timeline from about 22 days to approximately 15 days
 - By June 2007 an additional 5 days will be cut
- PRR 625 increased notice period for QSE dropping an LSE from 5 business days to 12 business days (effectively collateral)
- PRR 568 reduces settlement date from 17 to 10 days after operating day
- PRR 638 changes the settlement invoice due date from 16 calendar days to 5 business days
- PRR 643 reduces the number of days allowed to cure a breach from 3 days to 2 days

At one end:

Maintain current collateral requirements

- Over past 4 years, defaults have been charged to the market for less than \$0.01 / MWh in uplifts
- To fully collateralize for a Mass Transition, collateral requirements may double or triple
- Increases in collateral can restrict competition by requiring greater capital commitments, creating a barrier to new entrants and potentially forcing out existing ones or curbing growth
- Burdensome collateral requirements that a QSE cannot meet could drive a default in the future

At the other end:

Address credit risk not managed by previous changes

- Maintaining a financially stable market that attracts investment grade entities is desirable
 - Investment grade entities may be less likely to participate as QSEs in a market that expects QSEs to absorb potentially significant losses
- It is appropriate for entities operating in the electricity market to be required to demonstrate financial strength
- Higher credit risk entities should mitigate their own credit exposure
- Lower credit risk entities should not be required to “subsidize” those that are higher credit risk
 - Those that are financially strong have built this cost into their pricing structures

Various methods discussed to reduce credit exposure without increasing collateral:

- **Create a self-funded default reserve**
 - Potentially risk adjusted (higher risk entities pay at a higher rate)
 - Funded based on either their use of the BES, base amount of load, or a combination of both
- **Supply verification process**
- **Change (broaden) allocation for default uplift**
- **Reduce time to post collateral from 2 bus days to 1 bus day (munis and coops may continue to have 2 bus days)**
- **Reduce time to cure a breach from 2 bus days to 1 bus day**
- **Utilize credit insurance**
- **Define exposure in excess of 100% of collateral as an immediate breach**

Various methods discussed to reduce credit exposure using collateral:

- **Include full potential exposure at default in exposure calculation that reflects typical behavior of defaulting entities (e.g. leaning 100% on the BES)**
- **Use 52 week rather than 9 week “look back” period**
- **Create a working credit limit which allows an entity to utilize some % of collateral posted + unsecured (85/90%) rather than allow credit exposure to exceed 100% of posted collateral + unsecured credit limit**
- **Establish a “minimum” level of collateral required**

Areas of agreement and ongoing dialogue

- **Credit WG reached consensus on and will pursue initiating a PRR to:**
 - Reduce time to post collateral from 2 bus days to 1 bus day
 - munis and coops may continue to have 2 bus days
 - Reduce time to cure a breach from 2 bus days to 1 bus day
- **Credit WG extensively discussed and feel that there is potential in pursuing:**
 - Creating a self-funded default reserve
 - Creating a working credit limit which allows an entity to utilize some % of collateral posted + unsecured (85/90%) rather than allow credit exposure to exceed 100% of posted collateral + unsecured credit limit
 - Accepting some level of unmitigated credit exposure
 - Use of credit insurance for either “base” coverage or “excess” coverage

Revised timelines (in business days)

	<u>Orig</u>	<u>Curr</u>	<u>Long</u>	<u>Further</u>
Identify problem / make collateral call	0	0	0	0
<u>Notice periods</u>				
• Collateral due	2	2	2	1
• Notice of default given	3	2	2	1
• 2 BDays to cure default	6	4	4	2
<u>Mass transition</u>				
• Conference call to begin process	7	5	5	3
• POLRs initiate switches	10-12	8	6	4
• Switch complete by TDSP	16-18	11	8	6
Calendar days (approx)	<u>22-26</u>	<u>15-17</u>	<u>10-12</u>	<u>8-10</u>

Revised potential loss in exit scenario

Potential loss (simplified – w / 3 weeks of collateral) (in 000's)

	Orig	Curr	Long	Further
Collateral held				
1,000 MWh/day x \$100/MWh =	\$140	\$ 210	\$ 210	\$ 210
x 10% x 21 days				
At default				
1,000 MWh/day x \$100/MWh =	<u>\$ 2,200</u>	<u>\$ 1,500</u>	<u>\$ 1,000</u>	<u>\$ 800</u>
x 100% x ? days				
Potential market loss	\$ 2,060	\$ 1,290	\$ 790	\$ 590
For 100 MWh/day	\$ 206	\$ 129	\$ 79	\$ 59
For 10,000 MWh/day	\$20,600	\$12,900	\$ 7,900	\$ 5,900
Reduction in exposure		37%	62%	71%

Estimated Savings

<u>Entity</u>	<u>Est MWh/day</u>	<u>Est ESIDs</u>	<u>Tot Est</u> <u>Exposure</u>	<u>After Interim</u>		<u>After Final</u>	
				<u>Changes - Est</u> <u>Savings</u>		<u>Changes - Est</u> <u>Savings</u>	
LSE 2	3,500	12,250	5,160,000	4,941,000	96%	5,100,000	99%
LSE 1	350	3,000	410,000	355,000	87%	391,000	95%
QSE 2	65	550	200,000	91,000	46%	121,000	61%
QSE 1	50	500	30,000	10,000	33%	24,000	80%
LSE 3	1,500	10,000 (liab paid)	-	-			
QSE 3	125	2,500 (liab paid)	-	-			
Total			\$ 5,800,000	\$ 5,397,000		\$ 5,636,000	
Estimated residual liability				\$ 403,000		\$ 164,000	

Next steps

- **CWG will be voting to see if they can reach consensus on other measures**
- **CWG will report to F&A at their July meeting**
- **To the extent Credit WG identifies consensus around additional action items, it will file a PRR to propose changes to the Protocols.**

Note: While the Credit WG is made up of representatives from most market segments, as a Working Group, its voting rules are not structured to ensure that all segments are represented. Given that, the Credit WG will make recommendations and propose changes to Protocols that will be fully vetted by PRS and TAC.

Status Update

- **Consolidating and Reviewing Preliminary Budget Requests**
- **Conducting CFO/Director Review Meetings**
- **Assessing Staffing Requirements**
 - Operating & maintenance
 - Zonal projects
 - Texas Nodal Market Implementation Program impact on base operations resource requirements
 - Regional Entity
- **Reforecasting 2006 Expenditures Projections**
- **Schedule Check**

Assumptions

- **Efficiency of operations and cost consciousness**
- **Revenue**
 - ERCOT System Administration Fee at currently approved level - \$0.4171 per MWh
 - MWh growth 3.5% - producing approximately \$4.5 million additional revenue in 2007
- **Texas Nodal Market Implementation Program**
 - Direct program costs not included in ERCOT base operating budget
 - Funded through a temporary PUCT-approved surcharge
- **Staffing & Compensation**
 - Consistent with ERCOT's approved compensation strategy
 - Headcount for base operations to remain at current approved level of 589
 - 4% salary adjustment planned for merits and promotions
 - Variable Compensation Program eliminated

Assumptions (cont.)

- **Zonal Projects**
 - \$36.4 million portfolio
 - 60% debt funding / 40% revenue funding
- **Regional Entity**
 - Funding requirements included as identifiable increment in 2007 budget
 - Recovery
 - through NERC (approximately 80% – 90%)
 - through System Administration Fee (approximately 10% – 20%)
- **Independent Market Monitoring**
 - Funding requirements included as identifiable increment in 2007 budget
 - Consultant cost, ERCOT staff commitment, office space, and project investments

Assumptions (cont.)

- **Consultant and Contractor Utilization**
- **Employee Expenses**
- **Employee Events Eliminated**

Issues

- **“Cost Reduction Study”**
 - Suggestion offered by Chairman Hudson
- **Internal Control Objectives**
 - SOX 404
- **Communications Requirements**
 - PUCT staff
 - Legislative personnel
 - Market participants
- **NERC Security Requirements**
- **Other**

2007 Project Prioritization Status

- CO (Corporate Operations) and IO (IT Operations) reviewed and approved by PRS and TAC
- MO (Market Operations) reviewed and approved by COPS, PRS and TAC
- RO (Retail Operations) reviewed and approved by RMS, PRS and TAC
- SO (System Operations) reviewed and approved by WMS, ROS, PRS and TAC

- 2007 Zonal Project Prioritization and Funding Request**

Program Area	Budget Request	Project Count	Carryover \$	<u>Counts By Priority</u>		
				Carryover	Critical	High
CO	\$ 5,750,000	31	\$ 900,417	2	13	16
IO	\$16,000,000	14	\$1,322,316	5	8	1
MO	\$ 2,058,000	16	\$ 912,225	7	1	* 7
RO	\$ 7,659,000	11	\$4,385,000	5	0	6
SO	\$ 4,908,000	17	\$2,399,873	9	8	0
Total	\$36,375,000	89	\$9,919,831	28	30	30

* MO also plans to execute 1 "High/Medium" project

2007 Project Prioritization Notes by Program Area

- **CO**
 - Significant increase in requested funds due to enhanced ability to deliver projects that were prioritized low in prior years
 - Security staff is now in place
- **IO**
 - Large increase in funds requested for hardware replacement/upgrade
 - Hardware (primarily servers) is retired and upgraded every 3 to 4 years
 - 2007 and 2008 is the proper timeframe for this activity
- **MO**
 - Lower than usual budget request due to Nodal effort
 - Much of the MO list relates to EIS/EDW
- **RO**
 - Funding request is similar to prior years
 - Large Carryover item is for Texas SET 3.0/Mass Transition/T&Cs
- **SO**
 - Lower than usual budget request due to Nodal effort
 - Only Carryover and Critical projects will be executed

Summary – Fee case

- **Filed information package with PUC** **June 2**
- **Scheduled hearing** **July 21**
- **Temporary funding of ongoing Nodal costs is covered through currently established ERCOT debt facility**
 - Existing ERCOT debt facility was not “sized” to accommodate spending on the scale of Nodal
- **Expect to need additional borrowing capacity by Oct /Nov to maintain liquidity requirements under Financial Standard**

- **Begin conversations with potential lenders**
 - JPMorgan Chase (current lender-revolver/term)
 - other banks
 - Cooperative Finance Corporation (CFC)
 - Senior Note holders (current and possible)
 - Others
- **Currently will**
 - Identify potential financing structures
 - Understand where rates are currently
- **As ERCOT review options, we will look for**
 - Cost effective debt financing alternatives
 - Flexible structures
 - Interest rate risk mitigation strategies

- **Alternatives being considered**
 - Expansion of existing revolver and/or term facilities
 - Establish similar revolver facilities with another bank or the CFC
 - Addition of a new tranche of Senior Notes
 - Interest rate swaps as debt is added
 - Other
- **Expect to bring analysis of specific proposals for review in September and request approval of debt to execute in September or October**

- **Completing control self assessments on updated controls**
- **Receiving preliminary feedback from Deloitte & Touche on control framework for processes**
- **Addressing comments/suggestions provided by D&T on the control framework; making modifications if necessary**
- **D&T is performing transactional testing**
- **Current plan is for D&T to provide an initial report by the end of August**

- **CO17 & CO18 coordinated by Information Systems Security**
 - CO17: Logical Security Controls
 - 3 information requests received consisting of 63 requirements; 40 complete, 16 in process, 7 require clarification
 - 7 working groups tasked with providing information
 - CO18: Physical Security Controls
 - 3 information requests received consisting of 22 requirements; 1 request outstanding
 - 3 working groups tasked with providing information

- **In Process**

- In Planning for Identity & Access Mgmt Project; Execution scheduled to begin September 2006

- **Completed**

- Completed User Recertification effort for Logical Access Control—CO17 (Logical Security)
- Implemented 100% Monthly Audit for Facility Access Control—CO18 (Physical Security)
- Completed update of CCTV Cameras and Monitors—CO18
- Standardized Server Hardening and Configuration Guidelines—CO17

ERCOT Market Credit Status

	as of 05/31/2006				as of 06/30/2006					
	# 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	
Exposure in the ERCOT Market (owed to ERCOT)										
<u>QSEs that meet ERCOT Creditworthiness Standards</u>										
Ratings over BBB-	7	19,723,333	6%	221,449,377	U	6	22,049,374	7%	60,454,206	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated	37	129,020,519	42%	255,898,664	S	38	149,408,282	48%	292,504,282	S
Cash & Letters of Credit	11	161,987,474	52%	320,500,000	S	11	138,772,412	45%	304,217,000	S
Guarantee Agreements										
Total Exposure	55	310,731,326	100%			55	310,230,068	100%		
Other QSEs in the ERCOT Market (ERCOT owes)										
<u>QSEs that meet ERCOT Creditworthiness Standards</u>										
Ratings over BBB-	9	(5,663,794)	-8%	176,564,077	U	10	(11,931,460)	-15%	118,473,505	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated	41	(27,363,111)	-40%	79,593,425	S	45	(37,245,563)	-46%	94,473,527	S
Cash & Letters of Credit	11	(34,817,076)	-52%	120,200,000	S	13	(31,848,296)	-39%	120,544,000	S
Guarantee Agreements										
Total	61	(67,843,981)	-100%			68	(81,025,319)	-100%		
Total	116					123				

U: Unsecured credit limit assigned to QSEs that meet the creditworthiness standards

S: Secured credit limit (i.e. Collateral posted by QSEs that do not meet the creditworthiness standards or for QSE activity in excess of unsecured credit limit.)

Note: Reporting difference between May and June. In May the Unsecured Credit Limit is the maximum available unsecured credit.

In June (and going forward), the Unsecured Credit Limit is the limit set by ERCOT based on financial analysis and review of recent market activity.

The limit is reevaluated periodically as needed.

Audits Completed (last three months)

Internal Audits

- Congestion Management/TCR
- Lawson HR System
- MV90 System

External Audits

- 2005 Financial (PwC)

Open Audits

Internal Audits

- Payroll
- Credit (QSE)
- Outage Scheduling & Coordination
- Fraud Prevention (ongoing)

External Audits

- 2006 SAS70 (PwC)
- Internal Controls (D&T)

Planned Audits (next 3 months)

Internal Audits

- Ethics Compliance
- Consultants, Contractors & Compliance
- Investments
- Inventory & Fixed Assets
- Software Licensing & Maintenance

External Audits

- Texas Nodal Program Review (managed by IAD)
- 401k / MPP (PwC)

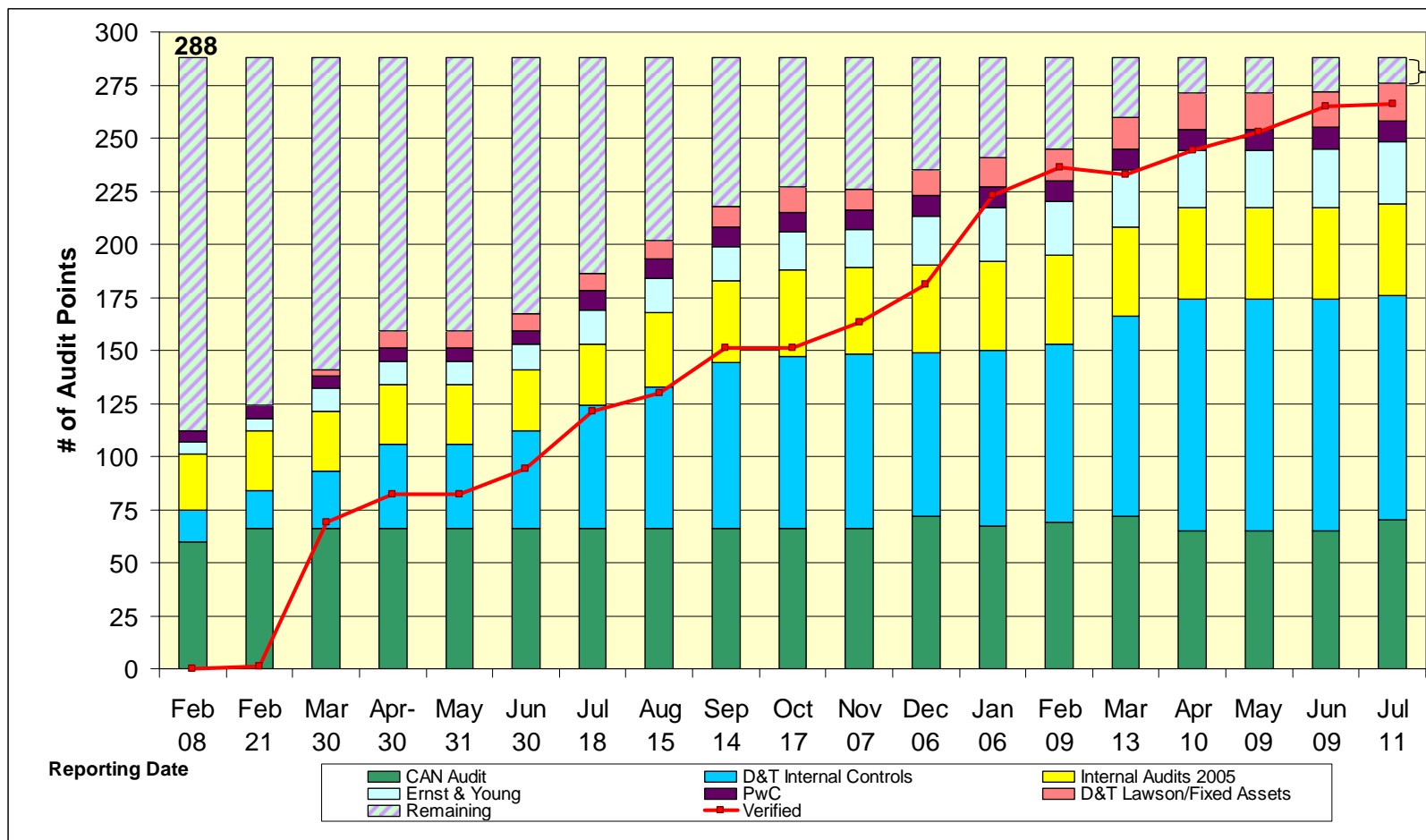
Planned Items (next 3 months)

External

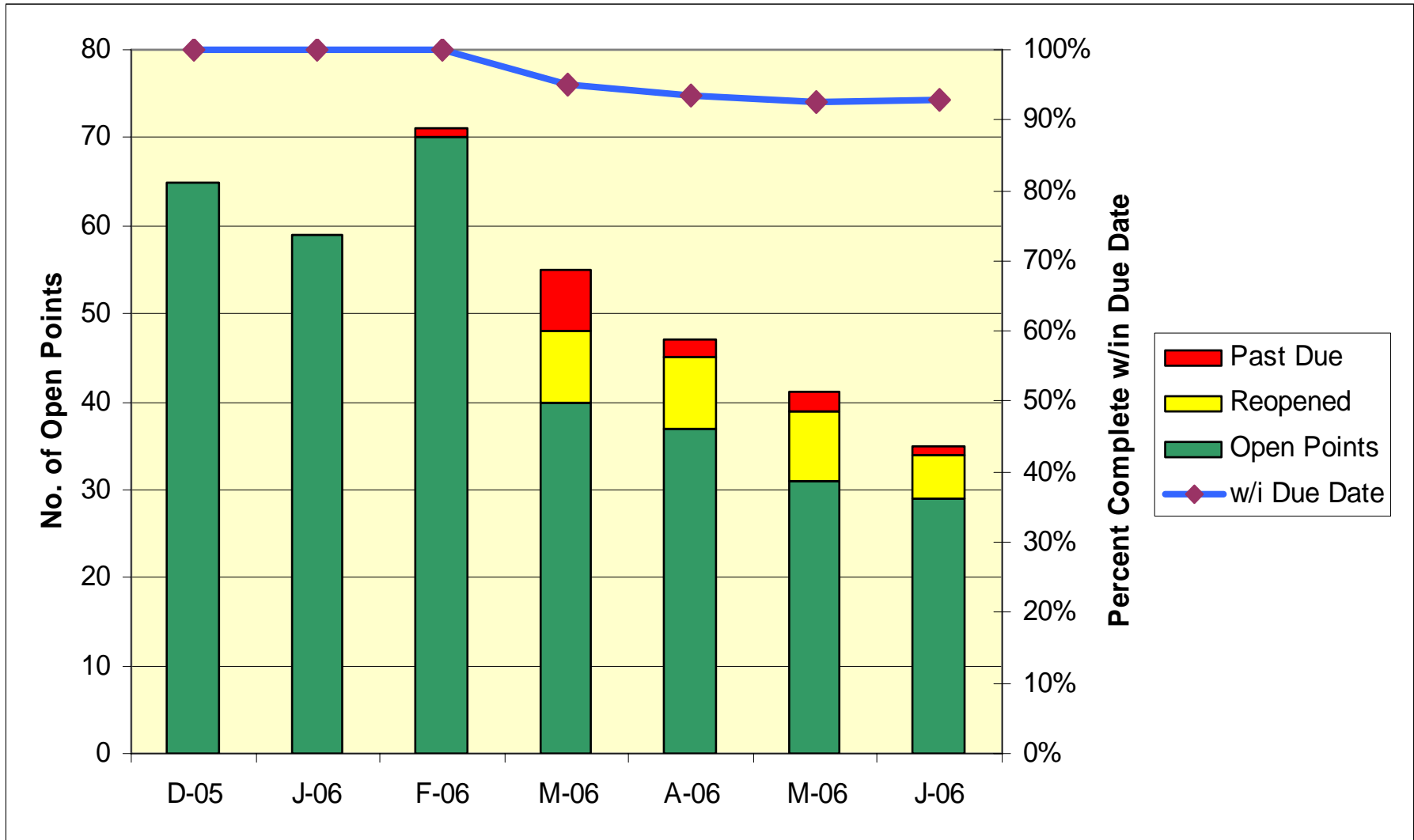
- Various reviews of ERCOT's network and system security posture.

Additional information can be provided during Executive Session

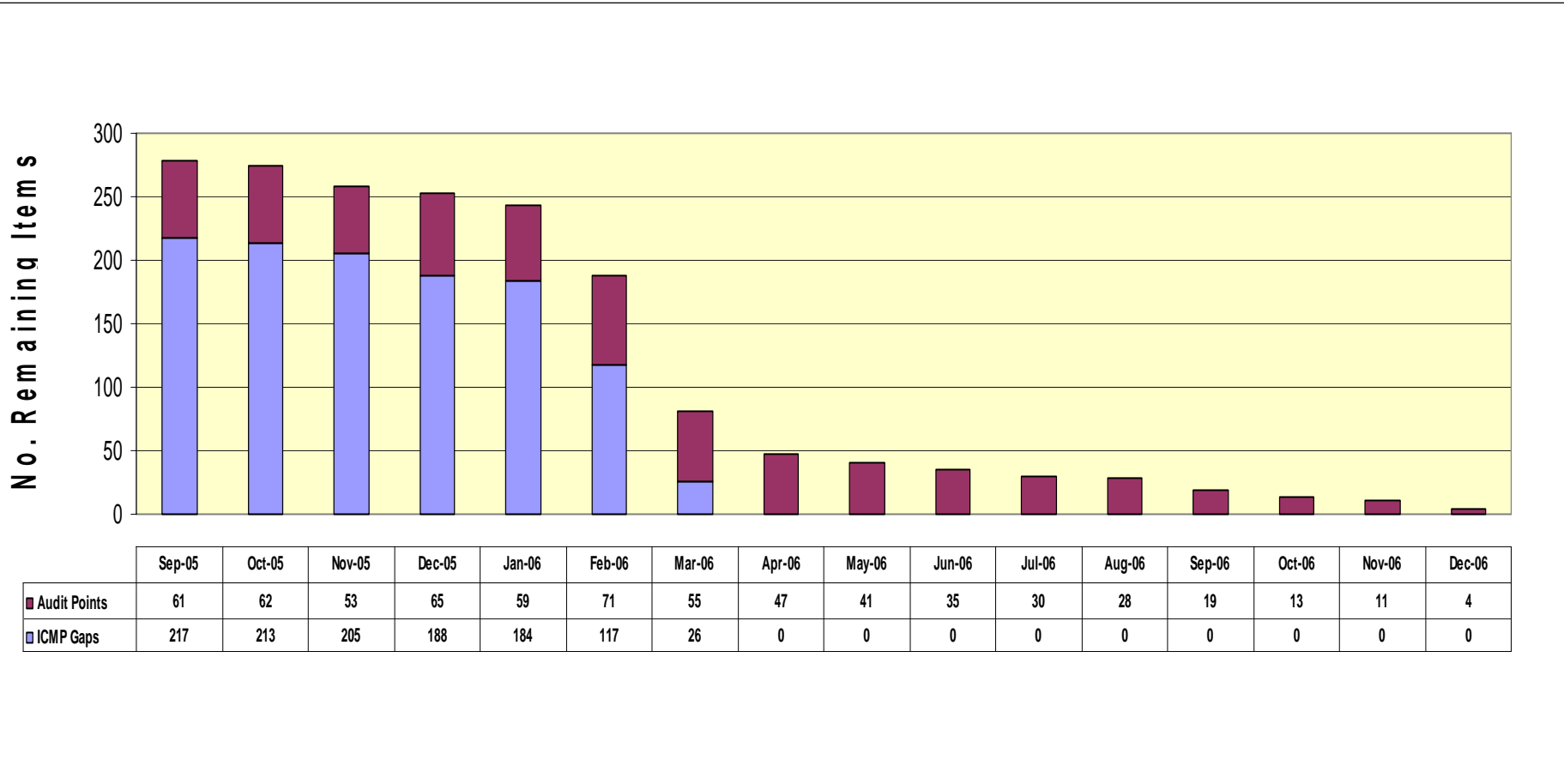
Completion Status by Audit 2004-05 Audit Points



Status of Open Audit Points - 2006



Projected Audit Point and ICMP Gap Progress



2007 Project Prioritization Status

- CO (Corporate Operations) and IO (IT Operations) reviewed and approved by PRS and TAC
- MO (Market Operations) reviewed and approved by COPS, PRS and TAC
- RO (Retail Operations) reviewed and approved by RMS, PRS and TAC
- SO (System Operations) reviewed and approved by WMS, ROS, PRS and TAC

2007 Zonal Project Prioritization and Funding Request

Program Area	Budget Request	Project Count	Carryover \$	Carryover	Critical	High
CO	\$ 5,750,000	31	\$ 900,417	2	13	16
IO	\$16,000,000	14	\$1,322,316	5	8	1
MO	\$ 2,058,000	16	\$ 912,225	7	1	* 7
RO	\$ 7,659,000	11	\$4,385,000	5	0	6
SO	\$ 4,908,000	17	\$2,399,873	9	8	0
Total	\$36,375,000	89	\$9,919,831	28	30	30

2007 Project Prioritization Notes by Program Area

- CO
 - Significant increase in requested funds due to enhanced ability to deliver projects that were prioritized low in prior years
 - Security staff is now in place
- IO
 - Large increase in funds requested for hardware replacement/upgrade
 - Hardware (primarily servers) is retired and upgraded every 3 to 4 years
 - 2007 and 2008 is the proper timeframe for this activity

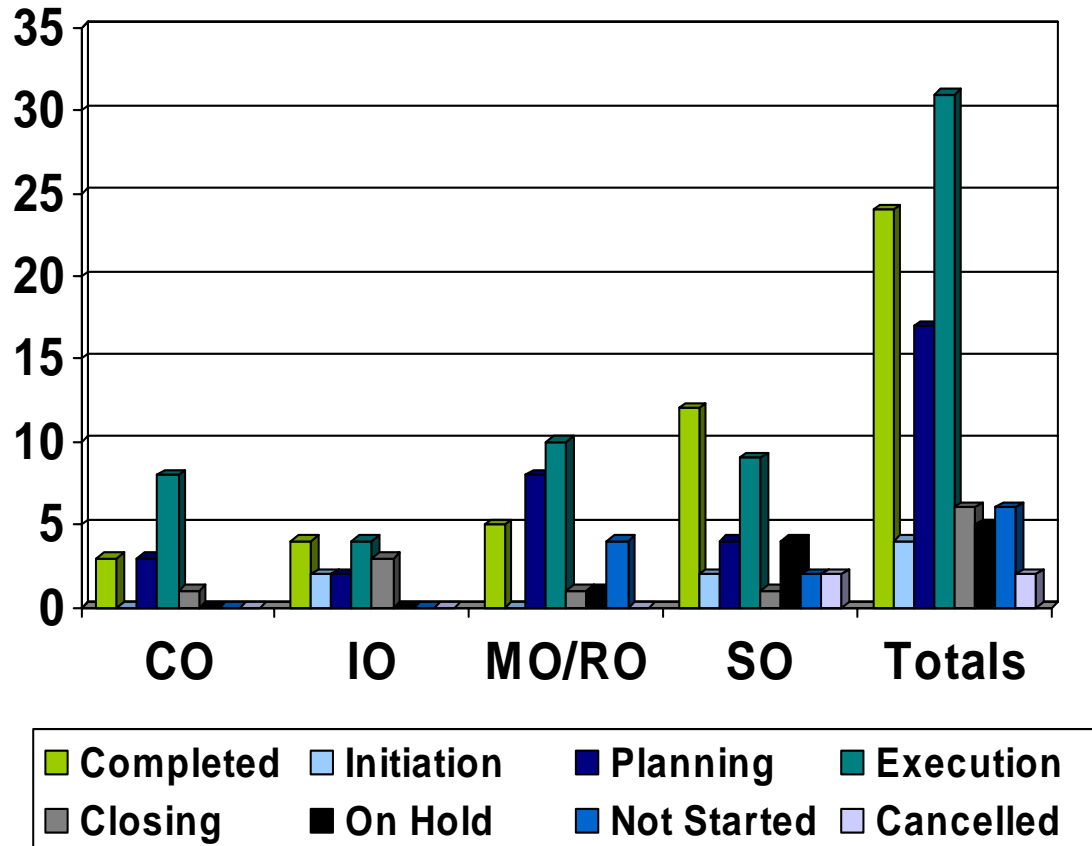
2007 Project Prioritization Notes by Program Area (cont.)

- MO
 - Lower than usual budget request due to Nodal effort
 - Much of the MO list relates to EIS/EDW
- RO
 - Funding request is similar to prior years
 - Large Carryover item is for Texas SET 3.0/Mass Transition/T&Cs
- SO
 - Lower than usual budget request due to Nodal effort
 - Only Carryover and Critical projects will be executed

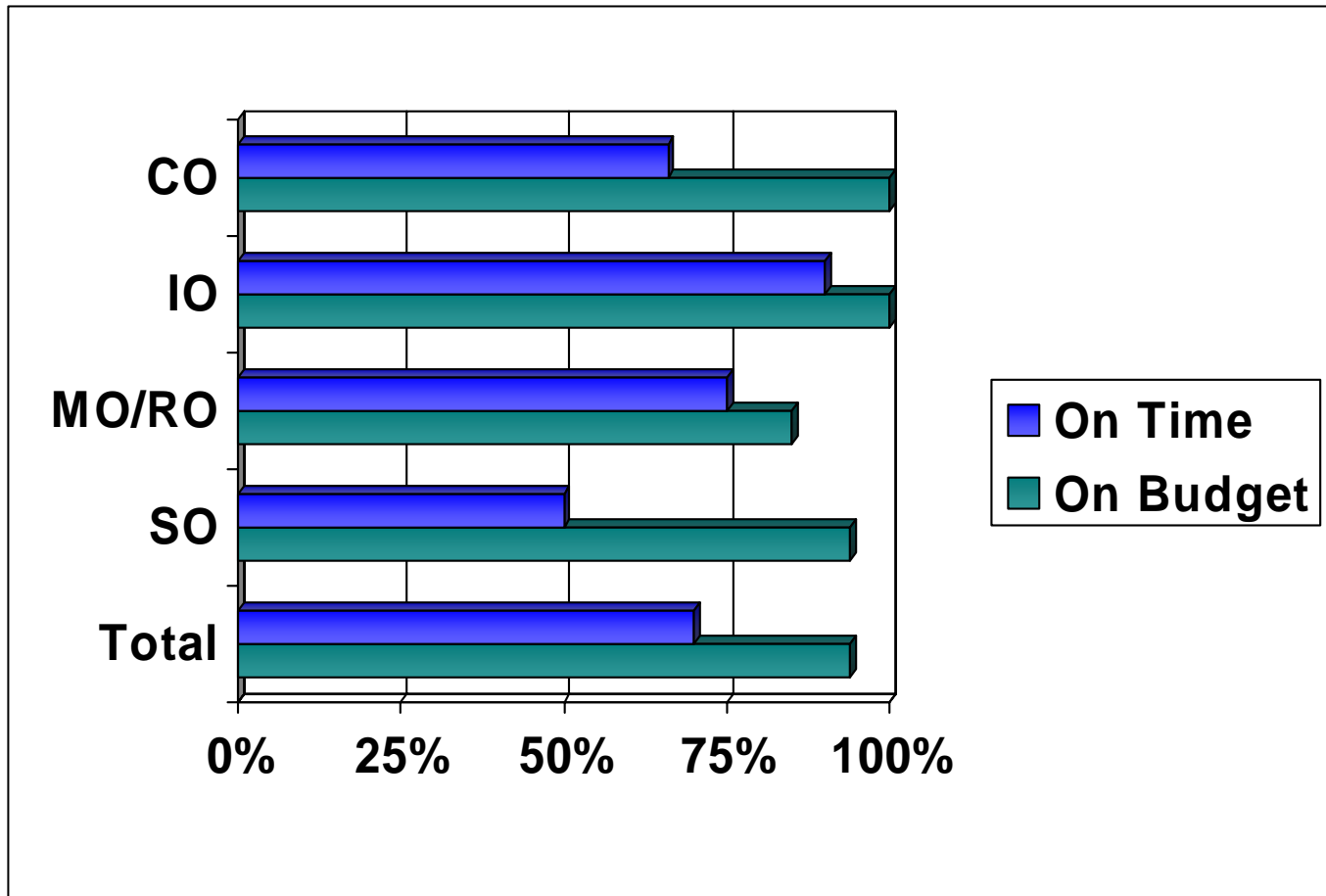
Project Totals

- **Completed Projects**
 - 2 completed in June
 - 19 completed YTD
- **Active Projects**
 - 4 in *Initiation*
 - 17 in *Planning*
 - 31 in *Execution*
 - 6 in *Closing*
- **Inactive Projects**
 - 5 projects *On Hold*
 - 6 projects *Not Started*
- **Cancelled Projects**
 - 2 cancelled YTD

Project Activity by Division

















Active and Projected Portfolio



Major ERCOT Projects Summary

Committee Brief-
Not on agenda

Project	Total Budget	Actual 06/30/06	Metrics	
Duration/Information (Sponsor)	Phase/Scheduled Completion		Schedule	Budget
Service Oriented Architecture (2004-2006)	\$6.1M	\$6.3M		
<i>3 separate projects over 12 mos. (R. Giuliani)</i>	<i>Execution Phase/4th Qtr 2006</i>			
Enterprise Data Warehouse (2003-2006)	\$3.5M	\$2.7M		
<i>9 separate projects over 36+ mos. (R. Hinsley)</i>	<i>Execution Phase/3rd Qtr 2006</i>			
Operator Training Simulator (2005-2006)	\$3.8M	\$560K		
<i>Training Simulator System for Operators (S. Jones)</i>	<i>Execution Phase/2nd Qtr 2007</i>			
Enhancements to FasTrak Tools (2005-2006)	\$2.5M	\$2.1M		
• Schedule moved from 6/17/06 to 8/26/06 with Mkt input; on track to complete on 8/26/06.				
<i>Tool for Tracking Market Issues (R. Giuliani)</i>	<i>Execution Phase/3rd Qtr 2006</i>			
Enhancements to SCR727 (2005-2006)	\$1.9M	\$501K		
<i>Entered into Execution (R. Giuliani)</i>	<i>Execution Phase/3rd Qtr 2006</i>			
Austin QA Build out (2005-2006)	\$1M	\$907K		
<i>Entered into Testing (R. Hinsley)</i>	<i>Execution Phase/3rd Qtr 2006</i>			
Enhancements to AREVA Study Tools (2006)	\$1.2M	\$290K		
<i>Entered Execution (S. Jones)</i>	<i>Execution Phase/1st Qtr 2007</i>			

- **PR-60004_01 EIS Conformed Data Warehouse Foundations**
 - Project Budget Approved: \$ 1,025,075
 - This project will ensure that the appropriate hardware and storage solutions are implemented to create an efficient and effective CDW environment to support ERCOT business users, Market Participants and the PUCT
 - Estimated \$500,000 on Oracle database licenses
- **Project Approach**
 - Hardware, Software, Licensing purchases necessary to support the transition and resource demands for EIS deliverables
 - Proof-of-concept for EIS multi-tiered storage approach
- **Request Approval to Move to Execution**

- **PR-60075_01 Identity & Access Management**
 - Project Budget Expected to Exceed \$1M

- **Project Approach**
 - Implement a sustainable compliance methodology to support the requirements of NERC, SAS70, and information security.
 - Provide a means to identify and track the identities of all persons accessing ERCOT's internal systems and information.
 - Improve productivity and accountability through the use of defined workflow, process improvement techniques, and automation to deliver value in the practices of provisioning and deprovisioning user access
 - Provide an improved user experience in access and password management
 - Sun Identity Manager has been selected based on a competitive bid process (8 respondents)

- **Project Status for Information**
 - Project kickoff September 2006
 - Outsourcing majority of implementation

- **PR-40086 Incident Report**

- **Scope:** Enterprise workflow automation solution to support business process in handling report of potential protocol violations from detection to closure or cancellation.
- **Deliverables:** Online user interaction screens using the Siebel System eEnergy solution that includes electronic mail notifications for required actions and status updates.
- **Timeline:** August 2004 - June 2006

- **PR-50147 – Windows Domain Restructuring**

- **Scope:** Re-architect and rebuild the ERCOT Windows Domain to fit under three domains rather than the current 14 autonomous domains.
- **Deliverables:** Construct new domains. Migrate and consolidate current domains.
- **Timeline:** Oct 2005 – June 2006

ERCOT Overall Projects Report

Reporting Period:

6/30/2006

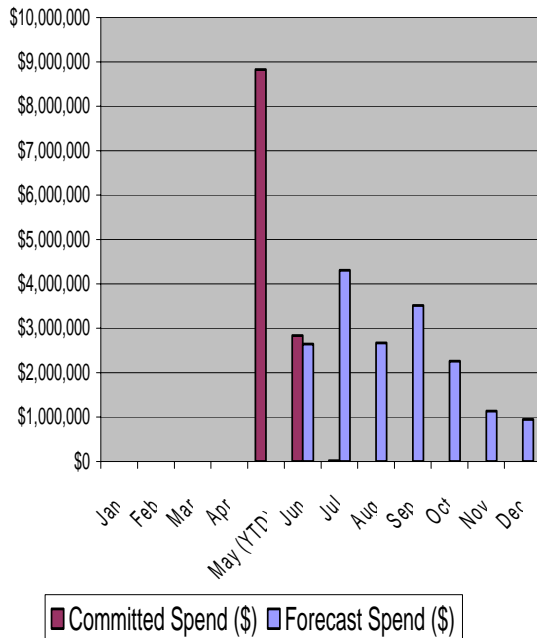
YTD

Summary

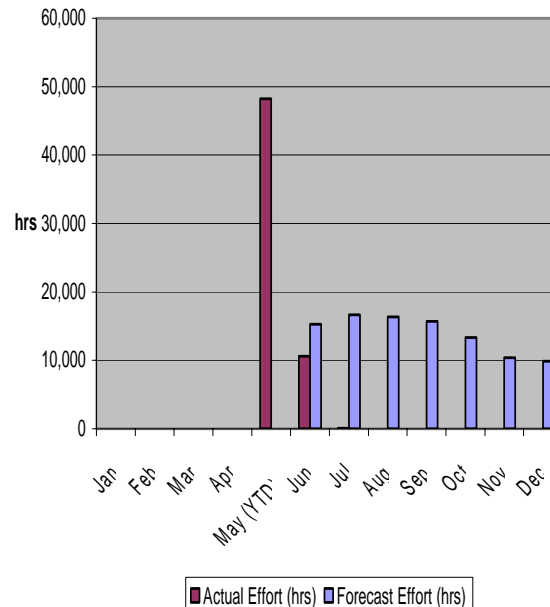
ERCOT Projects Leadership			Projects in ERCOT's Portfolio					Portfolio Performance			
Executives			On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
Sam Jones	Ray Giuliani		5	4	17	31	7	Y	Y	Y	
Ron Hinsley	Steve Byone	Completed	19	Total Active		60					
Projects Not Started:							6		Current Year Funding:	\$25,052,130	

Portfolio Performance Summary

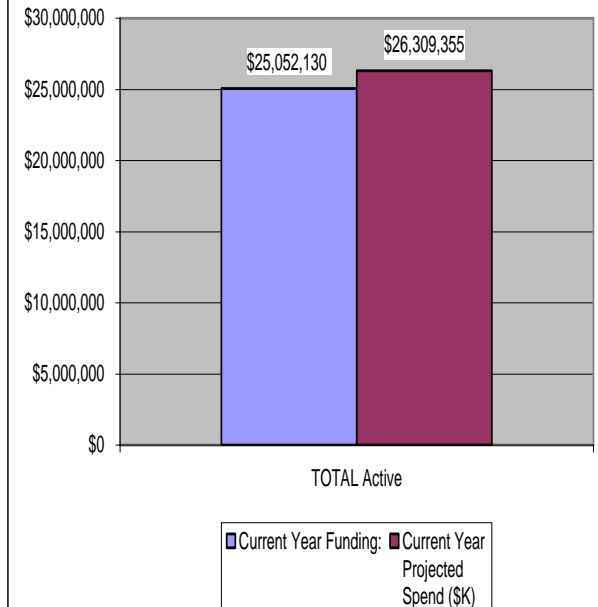
ERCOT Projects
Current Year - Spend



ERCOT Projects
Current Year - Effort

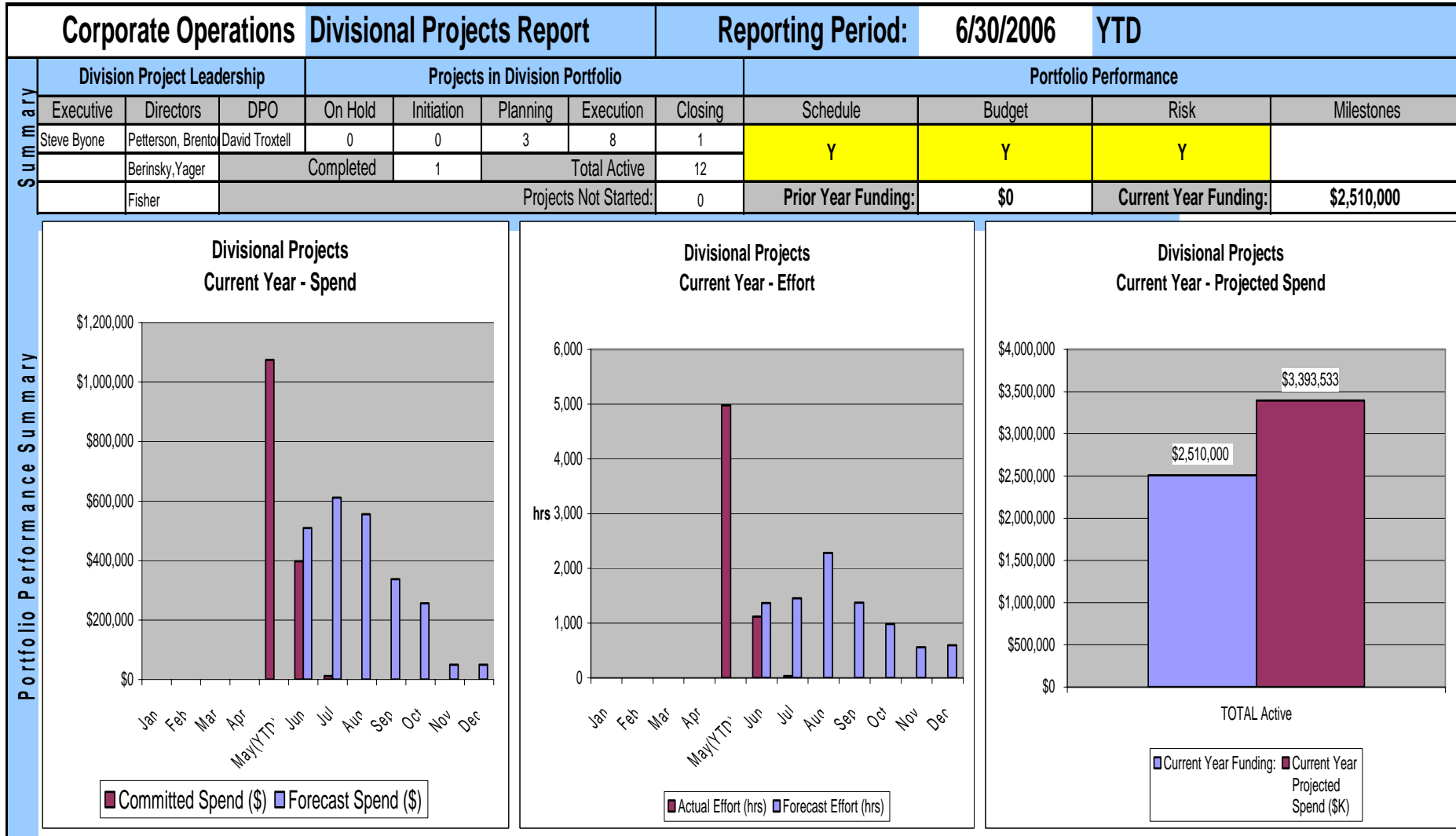


ERCOT Projects
Current Year - Projected Spend



Corporate Operations Divisional Projects Report

Committee Brief-
Not on agenda



IT Operations Divisional Projects Report

Committee Brief-
Not on agenda

IT Operations Divisional Projects Report

Reporting Period:

6/30/2006

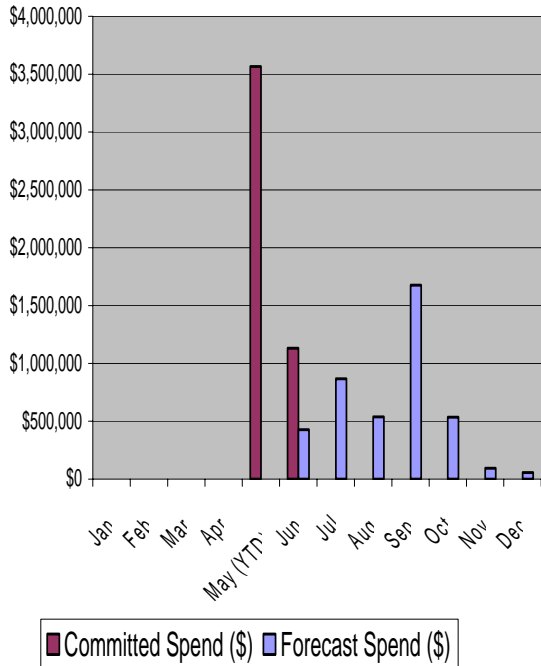
YTD

Summary

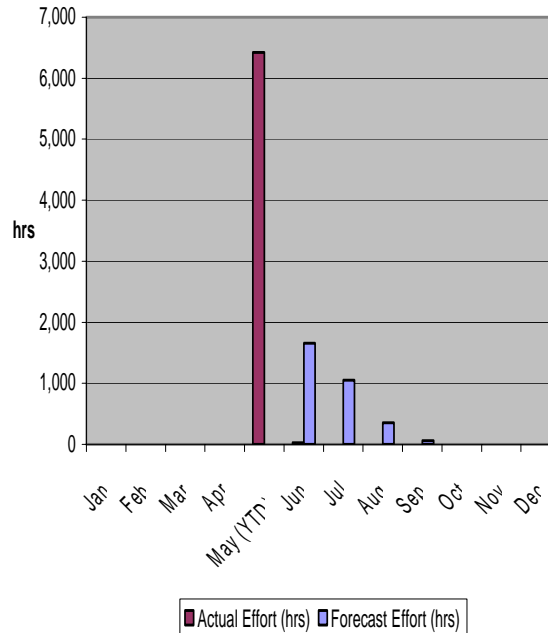
Division Project Leadership			Projects in Division Portfolio					Portfolio Performance			
Executive	Directors	DPO	On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
Ron Hinsley	David Johnson	John Kassel	0	2	2	4	3	G	G	Y	
	Lisa Petoskey	Completed	5	Total Active		11					
Projects Not Started:							0	Prior Year Funding:	\$0	Current Year Funding:	\$8,121,007

Portfolio Performance Summary

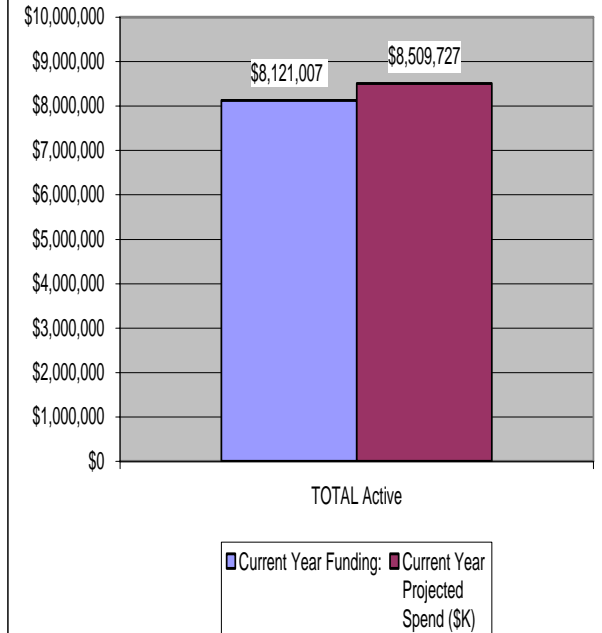
Divisional Projects
Current Year - Spend



Divisional Projects
Current Year - Effort



Divisional Projects
Current Year - Projected Spend



TOTAL Active

Legend:
■ Current Year Funding
■ Current Year Projected Spend (\$K)



Market Operations Divisional Projects Report

Committee Brief-
Not on agenda

Market Operations			Divisional Projects Report					Reporting Period:		6/30/2006	YTD	
Summary	Division Project Leadership			Projects in Division Portfolio					Portfolio Performance			
	Executive	Directors	DPO	On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
	Ray Giuliani	Richard Gruber	Adam Martinez	1	0	8	10	2	Y	G	Y	
		Betty Day		Completed	3	Total Active		20				
Projects Not Started:							4	Prior Year Funding:	\$0	Current Year Funding:	\$9,195,055	

Divisional Projects Current Year - Spend

Month	Committed Spend (\$)	Forecast Spend (\$)
Jan	0	0
Feb	0	0
Mar	0	0
Apr	0	0
May (YTD)	~2,800,000	0
Jun	~1,000,000	~1,300,000
Jul	0	~1,200,000
Aug	0	~1,100,000
Sep	0	~1,150,000
Oct	0	~800,000
Nov	0	~400,000
Dec	0	~300,000

Divisional Projects Current Year - Effort

Month	Actual Effort (hrs)	Forecast Effort (hrs)
Jan	0	0
Feb	0	0
Mar	0	0
Apr	0	0
May (YTD)	~25,500	0
Jun	~7,500	~9,500
Jul	0	~9,500
Aug	0	~9,500
Sep	0	~10,500
Oct	0	~9,000
Nov	0	~7,000
Dec	0	~6,500

Divisional Projects Current Year - Projected Spend

Category	Value (\$K)
Current Year Funding	9,195.055
Current Year Projected Spend	8,560.826

System Operations Divisional Projects Report

Committee Brief-
Not on agenda

System Operations			Divisional Projects Report					Reporting Period:		6/30/2006	YTD	
Summary	Division Project Leadership			Projects in Division Portfolio					Portfolio Performance			
	Executive	Directors	DPO	On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
	Sam Jones	Kent Saathoff	Gerry Abad	4	2	4	9	1	Y	G	Y	
				Completed	10	Total Active		16				
			Projects Not Started:		2	Prior Year Funding:		\$5,767,511	Current Year Funding:		\$5,226,068	

Divisional Projects Current Year - Spend

Month	Committed Spend (\$)	Forecast Spend (\$)
Jan	0	0
Feb	0	0
Mar	0	0
Apr	0	0
May (YTD)	~1,350,000	~250,000
Jun	~250,000	~380,000
Jul	0	~1,600,000
Aug	0	~450,000
Sep	0	~320,000
Oct	0	~680,000
Nov	0	~600,000
Dec	0	~500,000

Divisional Projects Current Year - Effort

Month	Actual Effort (hrs)	Forecast Effort (hrs)
Jan	0	0
Feb	0	0
Mar	0	0
Apr	0	0
May (YTD)	~11,000	~2,000
Jun	~2,000	~2,800
Jul	0	~4,500
Aug	0	~4,000
Sep	0	~3,800
Oct	0	~3,200
Nov	0	~2,800
Dec	0	~3,000

Divisional Projects Current Year - Projected Spend

Category	Amount (\$K)
Current Year Funding	\$5,226,068
Current Year Projected Spend	\$5,845,269

- **Continue to refine project planning process**
 - Implement resource planning process improvements (**In-progress**)
 - Finalize Divisional PPL active project plans and supporting resource demands (**Complete**)
 - Capture accurate resource availability (**In-progress**)
 - Verify projected staffing demands (**In-progress**)
 - Verify staffing commitments by Resource Manager (**In-progress**)
 - Clarify and resolve conflicts (**In-progress**)
- **Review projects impacted by Nodal** (**Completed initial assessment - ongoing process**)
- **Conduct 2007 project planning** (**Planning Completed - Approved through TAC, 7/6/2006**)
- **July BoD Update** (**Complete – this report**)

Future Agenda Items – August

- **Approval of 2007 Operating Budget**
- **Selection of Independent Auditor for 2006 and approval of projected fees**

F & A Yearly Schedule

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)
- √ •Required written communication and discussion of auditor independence
- √ •Review scope of annual financial audit
- √ •Report by CWG Chair on ERCOT credit policy

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)
- √ •Review and approve ERCOT Annual Report
- √ •Review operating plan and budget assumptions

Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Assessment of compliance, the internal control environment and systems of internal controls
- Review and approval of annual operating budget
- Report by CWG Chair on ERCOT credit policy
- Review updated year-end forecast

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
- Vote on CWG Chair
- Review requirements for membership in CWG
- Review and approve CWG charter
- Review updated year-end forecast

Recurring Items

- 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

√ Items completed for 2006