



Semi-Annual Compliance and Internal Control Update

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Vice President and Chief Financial Officer

Board of Directors Meeting

March 17, 2009































Enterprise Risk Management Update

- **Risk - potential for loss, harm, missed opportunity or failure**
- **Risk Management – ability to identify emerging patterns, anticipate events and adapt successfully**
 - No big surprises
 - No big mistakes
 - No such thing as perfect prevention
 - Crisis management when all else fails
- **Risk Governance**
 - Board has retained responsibility for risk oversight while delegating responsibility for risk management to the CEO
 - CEO has created a Risk Management Committee
 - Regular reports to F&A Committee
 - Semi-annual reports to Board

- **Enhanced risk analytics**
 - Monitoring more risk indicators
 - Portfolio (overall) credit risk exposure model pending
- **Quarterly risk mitigation report to F&A**
- **Infrastructure for risk management training & support**
 - Expanded reporting and risk assessment capability under development
 - Risk awareness training available for all ERCOT employees
 - ERM training developed for Directors and Managers
 - Basic on-line ERM resources available

March 2009 Risk Inventory "Stoplight" Report

ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC. RISK MANAGEMENT EVENT PROFILE MATRIX (as of March 1st, 2009)

 Strategic	 Operational Excellence	 Market Facilitation	 Grid Reliability	 Reporting	 Legal and Regulatory Compliance
 Strategy Development <i>Corporate objective setting adequately incorporates informed stakeholder input, market realities and management expertise.</i>	 Performance Monitoring <i>Clearly defined and actively monitored performance metrics linked to mission and goals - Performance status communicated and corrective action taken.</i>	 Customer Choice <i>Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired.</i>	 Grid Operations <i>Information required to operate the grid is efficiently gathered. Appropriate tools are prudently configured to efficiently operate the system.</i>	 Review Practices <i>Prudent measures are taken to insure that company disclosures are properly vetted and not misleading.</i>	 Legal & Legislative <i>Operations are conducted in compliance with all laws and regulations. Impacts of current and proposed legislation are understood and communicated.</i>
 Mission and Goals <i>Corporate objectives and performance standards are understood and followed.</i>	 Business Practices <i>Business planning, processes and management standards are effective and efficient.</i>	 Nodal Implementation Project <i>Nodal Implementation on budget on schedule, and within defined scope.</i>	 Planning <i>Long-range planning methods enable efficient responses to system changes that are necessary to maintain reliability standards.</i>	 Disclosure <i>Reporting and other disclosures to intended parties is timely, accurate and effective.</i>	 Internal Control Compliance <i>Internal Control Compliance, processes and management standards are effective and efficient.</i>
<p>New Strategic Plan needs to be integrated into the latest business planning cycle.</p>	<p>Annual review, training & testing for 2009 started in January. PUC Emergency Operations plan attestation to be issued by May 1st, 2009.</p>	<p>Program "RED" based on the old schedule & budget. New budget & schedule approved by the BOD. Management Action Plans developed for recommendations in Utilcast review # 9. No critical path milestones have been missed since the new schedule was base-lined in October 2008.</p> <p>Software integration and integration testing is a critical risk area of the program. The program is currently reorganizing teams to better support this area and leadership is working on risk mitigation plans. Data center capacity to support Nodal systems and the build out of integration testing (ITest) and EDS environments has been identified as another key risk. The program recently assigned project managers to these infrastructure projects and conducted project kick-off meetings. Project schedules expected in two weeks.</p>	<p>System Planning department staffing has reorganized/improved and a plan is in place to increase staff to meet stakeholder desire for more "study horsepower". A list of studies desired by ERCOT and ERCOT Stakeholders is being prepared and will be prioritized.</p>		<p>ERCOT is developing processes to institutionalize the ongoing training on current policies and procedures for all ERCOT staff and contract workers.</p>
 Reputation <i>Positive perceptions by stakeholders lead to less cost and greater flexibility resulting in enhanced enterprise value.</i>	 Workforce <i>Organization design, managerial and technical skills, bench strength and reward systems aligned with corporate goals.</i>	 Counterparty Credit <i>Maintain credit risk exposure for overall market within acceptable limits.</i>	 Bulk System Resources <i>Market Participants construct and make available adequate bulk electric grid resources.</i>	 Communication <i>Internal & external communications are timely and effective.</i>	 Industry Standards <i>Business practices provide stakeholders with required assurances of quality.</i>
<p>Increased publicity associated with the delay of the Nodal market and the associated cost increases, new fee filings for the nodal surcharge and System Administration fee, high congestion, high price volatility and credit defaults during 2008 have negatively impact ERCOT's reputation.</p>	<p>The rolling 12-month turnover has dropped to 6.4%. Contractor agreements have been modified for key individuals to continue work; however, there is still some risk of contractors leaving due to the shortened contracts until the PUCT approved the continuation of the Nodal project. ERCOT readiness continues to be an on-going issue with the delay in Nodal. Training is being reviewed to meet the needs of the Nodal market and procedures are currently being updated for ERCOT readiness. As of the end of February, ERCOT had 37 open full-time positions.</p>	<p>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 April.</p>			<p>Although current decentralized compliance activities are adequate, ERCOT is in the process of centralizing the compliance function to provide more focus on these issues. The Chief Compliance Officer started on Feb 1. We expect to announce the centralized compliance organization in March.</p>
 Fiscal Management <i>ISO design requires competent, prudent and cost effective provision of services.</i>	 Technology Infrastructure <i>Information systems, supporting facilities and data are effectively managed and are reliable.</i>	 Administration, Settlement & Billing <i>Market rules fairly applied to all participants. Accounting is timely and accurately reflects electricity production and delivery.</i>	 Operational Responsibility <i>Market participant conduct their operations in a manner which facilitates consistent grid reliability.</i>	 Adequacy and Integrity <i>Robust processes exist to support management assertions embodied within financial reports.</i>	 Regulatory Filings <i>Evidence, testimony and other supporting materials are compelling and successful.</i>
<p>Investment Standard - The BOD approved revisions to the Standard in February. All current investments are made within the scope of the new approved Standard.</p>	<p>Systems remain stable in all areas. The TCC1 data center expansion is planned for completion September 2009. Enough capacity for Nodal go-live and for the start of advanced metering will be available with the completion of the TCC1 expansion. The south side data center plan calls for full production operations by February 2011 and the new TCC3 facility to be ready by May 2011.</p>		<p>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 TAC Renewable Technologies Task Force is addressing a number of outstanding operational and planning issues regarding wind generation and is making recommendations on changes to more reliably integrate wind generation.</p>		

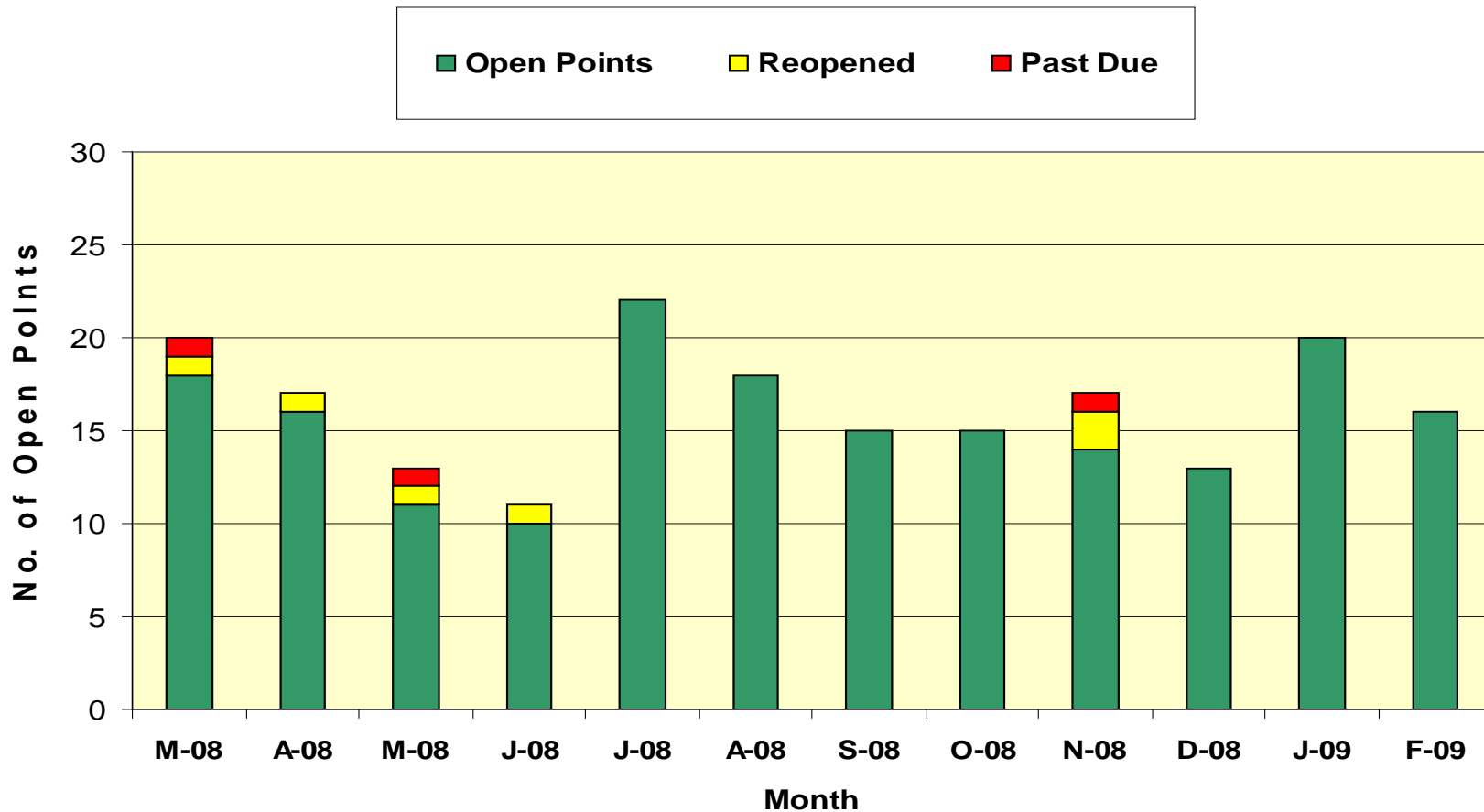
"Stoplight" Report Risk Rating Definitions

Green	Assessed levels of residual risk on a forward-looking basis for all identified potential occurrences are fully within management tolerance levels when all mitigating activities are considered.
Green-Yellow	Certain identified residual risks are outside management tolerance at the present time given current mitigating activities. The total levels of residual risk present a minimal threat to jeopardize the goals and objectives of ERCOT and mitigation plans must be in the process of being implemented in order to lower excessive residual risks to tolerable levels within a short period of time not to exceed two quarters .
Yellow	Certain identified residual risks are outside management tolerance at the present time given current mitigating activities. There may be more numerous identified risks than lower ratings or the potential consequences may be greater if any single or group of events occurs. The total levels of residual risk are more than minimal but still not likely to jeopardize the goals and objectives of ERCOT. Mitigation plans must be in the process of being implemented in order to lower any excessive residual risks to tolerable levels within a reasonable period of time not to exceed four quarters .
Yellow-Red	The residual risk of a given category after accounting for all mitigating activities is significantly outside management tolerance levels. Identified risks have a reasonable probability of occurring, which would jeopardize the goals and objectives of ERCOT. Proposed mitigation activities are either inadequate or would not reduce residual risk within an acceptable timeframe; however expected loss is not imminent and time is expected to be adequate to address identified residual risks prior to any likely occurrence.
Red	The residual risk of a given category after accounting for all mitigating activities is significantly outside of management tolerance levels. Identified risks have a substantial probability of occurrence which would jeopardize the goals and objectives of ERCOT. Proposed mitigation activities are either inadequate or would not reduce residual risk within an acceptable timeframe and there is a substantial probability that an identified residual risk will occur prior to the implementation of a mitigation strategy sufficient to lower the overall risk to a degree consistent with acceptable management tolerance levels.

Audit Update

- **2008 Financial Audit is underway**
- **2009 SAS70 Audit is scheduled to begin this month**
- **Internal Audit is on track with 2009 Audit Plan**
 - 3 audits completed to date, 9 audits in progress
 - Also performing audits/reviews based on special requests
- **2 Security Assessments planned in the next 3 months**
- **YTD 3 audit reports received with 15 audit points**
 - 6 audit points from Utilicast Report #8 included in ERCOT's standard audit tracking system in January

Status of Open Audit Points



Audits Completed	3	3	3	3	3	2	4	1	3	5	1	2
Points Added	11	3	0	6	11	2	0	0	4	11	12	9
Points Completed	9	6	4	8	0	6	3	0	2	15	5	13

All but one open audit point projected to be complete by September 30, 2009

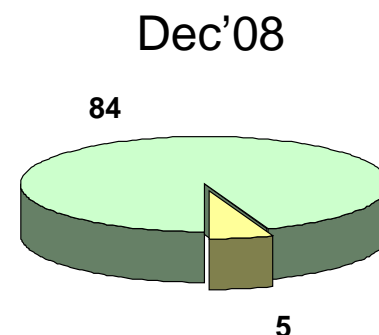
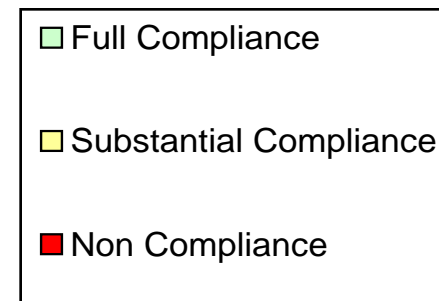
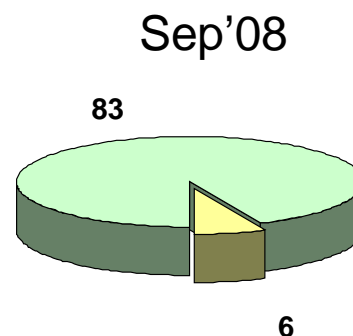
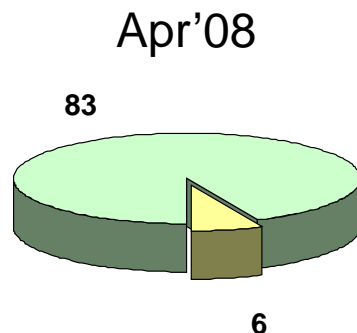
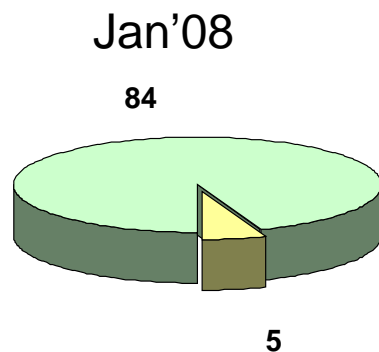
- **Internal Control Management Program (ICMP) is ERCOT's SOX compliance program (voluntary)**
- **ControlPath Compliance system enables routine monitoring of control effectiveness by management**
- **Policies and procedures are reviewed and updated at least annually**
- **Changes to policies/procedures are periodically communicated to all ERCOT staff and contract workers**
- **The Internal Audit function tests effectiveness of controls during audits**

Adequate tools are in place to maintain a controlled environment

Compliance Update

- 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 December 31, 2008.

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.

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.