



**ERCOT Finance & Audit Committee Meeting**  
**7620 Metro Center Drive, Austin, Texas**  
**Met Center, Conference Room 206**  
**May 18, 2010; 7:30am – 9:55am\***

Item #	Agenda Item Type	Description/Purpose/Action Required	Presenter	Time
1.		Call to order Executive Session	C. Karnei	7:30am
2.		2a. Announcement of proxies	C. Karnei	7:31am
	Decision required	2b. Approval of executive session minutes (Vote) (4/20/10)	C. Karnei	7:32am
	For discussion	2c. Review of Market Reform's Internal Audit staffing recommendations	B. Wullenjohn / T. Doggett	7:35am
	For discussion	2d. Discussion of proposed F&A survey of Internal Audit	B. Wullenjohn	7:50am
	For discussion	2e. Update of 2010 Internal Audit Goals	B. Wullenjohn	8:00am
	For discussion	2f. Internal Audit status report	B. Wullenjohn	8:10am
	Informative	2g. EthicsPoint update	B. Wullenjohn	8:15am
	Decision required	2h. Discussion of debt financing proposal (Vote)	C. Yager	8:20am
	Informative	2i. Preview of Board insurance update	C. Yager	8:45am
3.	Informative	Contracts, personnel, litigation and security	Various	8:50am
		Recess Executive Session		8:55am
		<b>Convene General Session</b>		
4.	Decision required	Approval of general session minutes (Vote) (04/20/10)	C. Karnei	8:55am
5.	Decision required	Approval of Internal Audit department charter (Vote)	B. Wullenjohn	8:56am
6.	Decision required	Approval of debt financing proposal (Vote)	C. Karnei	8:58am
7.	Decision required	Annual review of Market Credit Risk Corporate Standard (Vote)	R. Baker	9:00am
8.	For discussion	Review the Company's dealings with any financial institutions that are also market participants	L. Swanson	9:20am
9.	Decision required	Preapproval of non-audit services from the independent auditor (Vote)	M. Petterson	9:25am
10.	For discussion	Review the procedures for handling reporting violations	M. Petterson	9:35am
11.	Informative	Committee Briefs (Q&A only)	All	9:40am
12.	Informative	Future agenda items	M. Petterson	9:45am
13.		Other business	M. Petterson	9:50am
		Adjourn ISO meeting	C. Karnei	9:55am

*\* Background material is enclosed or will be distributed prior to meeting. All times shown in the agenda are approximate. The next Finance & Audit Committee Meeting will be held Tuesday, June 15, 2010, at ERCOT, 7620 Metro Center Drive, Austin, Texas 78744, in Room 206.*

Decision required
For discussion

## 4. Approval of General Session Minutes Clifton Karnei

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### **Approval of General Session Minutes**

- Vote 04/20/10

**DRAFT ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.  
MINUTES OF THE FINANCE & AUDIT COMMITTEE – GENERAL SESSION**

7620 Metro Center Drive (Room 206) – Austin, Texas 78744

April 20, 2010

Pursuant to notice duly given, the Finance & Audit Committee (“Committee”) of Electric Reliability Council of Texas, Inc. (“ERCOT”) convened on the above-referenced date. Committee Chairman Clifton Karnei confirmed that a quorum was present and called the meeting to order at approximately **8:03 a.m.** The Committee immediately went into Executive Session, where it remained until it recessed and reconvened to General Session at **9:07 a.m.**

**General Session Attendance**

Crowder, Calvin	American Electric Power Service Corporation	Investor Owned Utility	Not Present
Dreyfus, Mark	Austin Energy	Municipal	Present
Espinosa, Miguel (Vice Chair)	Unaffiliated Board Member	Unaffiliated Board Member	Present
Fehrenbach, Nick	City of Dallas	Commercial Consumers	Present
Gent, Michehl	Unaffiliated Board Member	Unaffiliated Board Member	Present
Karnei, Clifton (Chair)	Brazos Electric Power Cooperative	Cooperative	Not Present
Zlotnik, Marcie	StarTex Power	Independent REP	Present

**Other Board Members and Segment Alternates:**

Packard, Michael	South Texas Electric Cooperative	Cooperative	Present
Prochazka, Scott	CenterPoint Houston Energy	Investor Owned Utility	Present
Walker, Mark	NRG Texas	Independent Generator	Present
Whittle, Brandon	DB Energy Trading	Independent Power Marketer	Present

**ERCOT Staff and Guests:**

Baker, Randy	ERCOT – Director, Credit Risk Management
Beckham, Rebecca	ERCOT – Senior Financial Analyst
Day, Betty	ERCOT – Director, Commercial Operations
Deskins, Andy	Wachovia
DiPastena, Phil	ERCOT – Enterprise Risk Manager
Doggett, Trip	ERCOT – Interim Chief Executive Officer
Gunn, Phil	Ernst & Young
Jones, Brad	Luminant
Lester, Susan	ERCOT – Executive Assistant, Finance
Manning, Chuck	ERCOT – Vice President and Chief Compliance Officer
Medina, Eric	ERCOT – Opportune Consultant
Morehead, Juliana	ERCOT – Associate Corporate Counsel

Morgan, Richard	ERCOT – Vice President and Chief Information Officer
Nikazm, Tamila	Austin Energy
Sisson, Taylor	Ernst & Young
Stauffer, Tarra	ERCOT – Legal Assistant
Swanson, Leslie	ERCOT – Treasury Manager (Contractor)
Taylor, William	Calpine
Wolff, Freddy	ERCOT – Manager, Accounting and Financial Reporting
Wullenjohn, Bill	ERCOT – Director, Internal Audit
Yager, Cheryl	ERCOT – Treasurer

### **Announcement of Proxies**

Scott Prochazka with Centerpoint Energy introduced himself as the segment alternate for Calvin Crowder. Mike Packard with South Texas Electric Co-op introduced himself as the segment alternate for Clifton Karnei.

### **Discussion with External Auditor: Ernst & Young**

Messrs. Gunn and Sisson of Ernst & Young provided the Committee with comments concerning its governance processes and the oversight responsibilities of ERCOT. The auditors noted that the Committee exceeded the performance of other F&A committees at companies of similar size and structure as ERCOT. Mr. Gunn stated that the Committee’s Charter is “comparable or better than many of the public company charters that you see,” and the Committee’s monitoring of ERCOT internal controls over financial reporting appeared positive due to ERCOT’s clear and precise internal audits and reports. The Committee was commended on its involvement with nonfinancial business matters. In response to the Committee’s self-assessments, the auditors suggested that to improve its level of education, the Committee should participate in formal training on governance, financial and/or internal audit matters. However, they stated that the Committee was “probably not giving as much credit to [itself] as [it] should be.” In concluding, the auditors recommended that as a best practice, the Committee implement an annual presentation to address significant business and/or fraud risks, as well as draft a Charter checklist to ensure that it accomplishes all of its Committee responsibilities for the year.

### **Approval of Prior Meeting General Session Minutes**

**Mr. Dreyfus moved to approve the minutes for the General Session of the Committee meeting held on March 23, 2010. Mr. Gent seconded the motion. The motion passed unanimously with no abstentions.**

### **Quarterly Investment Update**

Leslie Swanson, ERCOT’s interim Treasury Manager, reviewed ERCOT’s first quarter investments and noted that overall investments were relatively flat compared to year-end. She informed the Committee that ERCOT’s investment strategy remained consistent with the prior quarter, and though the general market was rebounding, ERCOT had not yet seen an improvement in rates. In conclusion, Ms. Swanson reported that ERCOT’s net write-off of the remaining balance in The Reserve is approximately \$584,000.00. She also provided the Committee with a revised Attachment C to substitute for the one in the Committee materials.

Cheryl Yager highlighted Footnote 3 of the Committee materials and asked whether the Committee was opposed to eliminating the note in the future since it referred to Reserve Fund receipts, given that all funds expected to be received have been received by ERCOT. Mr. Espinosa commented that it should be removed with the exception that should a noteworthy issue arise related thereto, the footnote would be reinserted in the materials.

### **Review Procedure for Setting Day Ahead Market (“DAM”) Auction Credit Requirement Parameters**

Ms. Yager had a high-level discussion with the Committee concerning new procedures referenced in NPRR 206, which was passed in February 2010. She noted that NPRR 206 made changes to DAM market auction procedures. Concerning bids, NPRR 206 allows bids to be valued somewhere between the bid price and the recent historical price, whereas only bid price was used to formulate bid value before NPRR 206. Concerning energy-only offers, Ms. Yager informed the Committee that the Market Credit Work Group and the Credit Working Group had been meeting to determine whether to grant credit on offers, and if so, how much credit to give, and the procedures for determining whether to grant credit. In trying to balance the normal business need with the risks involved, Ms. Yager told the Committee that the market (with ERCOT’s input) arrived at a position that would allow zero credit in a base case scenario. However, the procedure provides an option that would allow ERCOT to grant credit to Market Participants that provided certain information. This option would require more active management on ERCOT’s part. She then gave some examples of variables, and an overview on how procedures were established and e-factors.

Tamila Nikazm, Vice Chair of the Credit Work Group, gave the Committee a summary of the Credit Work Group’s endorsement of NPRR 206 and the procedure to set the DAM market auction credit requirement. Ms. Nikazm stated that she believed the parameters would adequately collateralize the market and protect it by: (1) giving ERCOT sufficient flexibility to adjust a Market Participant’s collateral requirement to the same level as pre-NPRR 206 if necessary; (2) requiring Market Participants seeking favorable treatment under the procedure to give ERCOT advance notice of changes in their DAM market activities; and (3) where necessary, allowing ERCOT to request additional information/disclosure from a Market Participant seeking favorable treatment. Moreover, Ms. Nikazm clarified that the Committee could change these parameters without going through the NPRR process, thereby expediting adjustment of the parameters while trying to keep the market stable.

Mr. Gent asked whether these parameters were designed to reduce collateral requirements. Ms. Nikazm responded that they could reduce the collateral requirement, but could also maintain it at the same level as pre-NPRR 206.

Mr. Espinosa requested a motion to vote to recommend the endorsement of the procedure to set the DAM market auction credit requirement.

**Mr. Dreyfus moved to recommend the methodology for the parameters for setting DAM auction credit requirements. Ms. Zlotnik seconded the motion. The motion passed unanimously with no abstentions.**

### **Review and Accept Results of the Annual Financial Statement Audit**

Mr. Espinosa reminded the Committee that Ernst & Young's unqualified audit of ERCOT's 2009 financials was very complimentary. Mr. Petterson then stated that Ernst & Young's opinion was clean, there were no audit adjustments, and no cited weaknesses of internal control.

Mr. Espinosa requested a motion to vote to accept Ernst & Young's Unqualified Audit Report of ERCOT's 2009 financial statement.

**Mr. Fehrenbach moved to accept the results of the annual Financial Statement Audit. Mr. Gent seconded the motion. The motion passed unanimously with no abstentions.**

The Committee then briefly discussed Ernst & Young's opinion. Mr. Gent suggested that the Committee should place more emphasis on the way it asks questions in the annual self-evaluation. Mr. Espinosa noted the importance of the Committee's candor when answering the evaluation's questions, while following up once a year for a reassessment of where it stands. He concluded by reiterating that the overall the audit report was good, though the Committee could use improvement in some areas.

### **Committee Briefs**

Ms. Yager reminded the Committee that Commissioner Smitherman requested interest rate swap information be discussed with/given to the Board. She referenced a slide in the financial reports section of the board materials to which the Committee could refer.

### **Future Agenda Items**

The following items were identified as future agenda items:

1. Standing Internal Audit
2. Vote to approve Internal Audit Department Charter
3. Review the procedures for handling and reporting violations
4. Review operating plan and budget assumptions
5. Preapproval of non-audit services from ERCOT's independent auditor
6. Conduct annual review of insurance coverage(s)
7. Review ERCOT's dealings with any financial institutions that are also market participants
8. Review ERCOT's Annual Report
9. Committee briefs
10. Future agenda items

### **Other Business**

None.

### **Adjournment**

Mr. Espinosa adjourned the meeting at approximately **9:44 a.m.**

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Juliana Morehead  
Associate Corporate Counsel

## **Annual Approval of the Internal Audit Department Charter (Proposed Charter attached as a separate document)**

- Vote
- Internal Audit requested changes this year to the Charter to bring it into conformance with the Institute of Internal Auditors' new *International Professional Practices Framework (IPPF)* that became effective on January 1, 2009. The IPPF contained some new guidance and requirements that impacted Internal Audit Charters.
- At the April 20, 2010, F&A Committee meeting where the proposed Charter was discussed, there were no changes requested by the Committee to the proposed Charter presented at the Committee meeting. The Committee indicated that it was supportive of the language in the proposed Charter and would formally vote to approve the Charter at the May 18, 2010, Committee meeting.
- On April 30, 2010, the Chief Executive Officer reviewed the proposed Charter and did not recommend any changes.



## Internal Audit Department Charter

### MISSION AND SCOPE OF WORK

The mission of the Internal Audit Department is to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The scope of work of the Internal Audit Department is to determine whether the organization's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- The systems of internal control established to ensure compliance with ERCOT's policies, plans and procedures, laws, and regulations are adequate and functioning as intended.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial, and operating information is accurate, reliable, and timely.
- Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the organization's control process.
- Significant legislative or regulatory issues impacting the organization are recognized and addressed properly.

Opportunities for improving management control, economy, and the organization's image may be identified during audits. They will be communicated to the appropriate level of management.

### ACCOUNTABILITY

The Director of Internal Audit is the Chief Audit Executive at ERCOT. The Chief Audit Executive (CAE), in the discharge of his/her duties, shall be accountable to management and the Finance and Audit Committee of the Board of Directors to:



- Provide annually an assessment on the adequacy and effectiveness of the organization's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
- Report significant issues related to the processes for controlling the activities of the organization and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
- Provide information periodically on the status and results of the annual audit plan and the sufficiency of department resources.
- Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

## **INDEPENDENCE**

To provide for the independence of the Internal Audit Department, its personnel report to the CAE, who reports administratively to the Chief Executive Officer and functionally to the Finance and Audit Committee of the Board of Directors in a manner outlined in the above section on Accountability. The Internal Audit Department will include as part of its reports to the Finance and Audit Committee, a regular report on internal audit personnel.

## **RESPONSIBILITY**

The CAE and staff of the Internal Audit Department have responsibility to:

- Develop a flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the Finance and Audit Committee for review and approval.
- Implement the annual audit plan, as approved, including, and as appropriate, any special tasks or projects requested by management and the Finance and Audit Committee.
- Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter.
- Establish a quality assurance program by which the CAE assures the operation of internal auditing activities.
- Perform consulting services, beyond Internal Audit's assurance services, to assist management in meeting its objectives. Examples may include facilitation, process design, training, and advisory services. When performing these consulting services, the Internal Audit Department will maintain and monitor its independence and objectivity.
- Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
- Issue periodic reports to the Finance and Audit Committee and management summarizing results of audit activities.
- Keep the Finance and Audit Committee informed of emerging trends and successful practices in internal auditing.

- Provide a list of significant measurement goals and results to the Finance and Audit Committee.
- Assist in the investigation of significant suspected fraudulent activities within the organization and notify management and the Finance and Audit Committee of the results.
- Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost.

## **AUTHORITY**

The CAE and staff of the Internal Audit Department are authorized to:

- Have unrestricted access to all functions, records, property, and personnel.
- Have full and free access to the Finance and Audit Committee.
- Allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.
- Provide assurance services to external parties (e.g., the PUCT per Protocol 1.4.3.1.(2)).

The CAE and staff of the Internal Audit Department are not authorized to:

- Perform any operational duties for the organization or its affiliates.
- Initiate or approve accounting transactions external to the Internal Audit Department.
- Direct the activities of any organization employee not employed by the Internal Audit Department, except to the extent such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors.
- Implement internal controls, develop procedures, install systems, prepare records, or engage in any other activity that would normally be audited.

## **STANDARDS OF AUDIT PRACTICE**

The Internal Audit Department will govern itself by adherence to the Institute of Internal Auditors' mandatory guidance including the definition of Internal Auditing, the Code of Ethics, and the *International Standards for the Professional Practice of Internal Auditing*. This mandatory guidance constitutes statements of the fundamental requirements for the professional practice of internal auditing and for evaluating the effectiveness of the Internal Audit Department's performance and constitute an addendum to this charter.

The Institute of Internal Auditors' Practice Advisories, Practice Guides, and Position Papers will also be adhered to as applicable to guide operations. In addition, the Internal Audit Department will adhere to ERCOT's policies and procedures and Internal Audit's procedures guide.

**PERIODIC ASSESSMENT**

The Chief Audit Executive should at least annually assess whether the mission, responsibility, and authority, as defined in this charter, continue to be adequate to enable the Internal Audit Department to accomplish its objectives. The result of this annual assessment should be communicated to senior management and the Finance and Audit Committee.

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William G. Wullenjohn, Sr.  
Director, Internal Audit Department  
Chief Audit Executive

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Trip Doggett  
Interim President and Chief Executive Officer

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Clifton Karnei  
Finance and Audit Committee Chair

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Dated

## 6. Approval of Debt Financing Proposal Clifton Karnei

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**<Vote>**

## 7. Annual Review of Market Credit Risk Corporate Standard

Randy Baker

- **Market Credit Risk Standard must be reviewed at least annually by the Finance & Audit Committee or when updates are needed**
- **Exceptions requested – No running of zonal model for**
  - 2nd Quarter 2010
  - 3rd Quarter 2010
- **Clarifications**
  - Independent review within one year *after* Nodal go-live.
  - Stress scenarios at request of BOD, TAC & CWG.

## 7. Annual Review of Market Credit Risk Corporate Standard: Changes to Market Credit Risk Standard – Nodal Transition

- **Additional risk factors from Nodal Market**
  - Day Ahead Market
  - Congestion Revenue Rights
- **Other issues**
  - Possible redevelopment of model on alternative platform
- **Planning underway**
  - Possible involvement by Oliver Wyman (Original consultant hired to develop zonal model in 2007)
    - ERCOT currently in discussions with OW
    - Seeking optimal combination of ERCOT & OW involvement
  - Timing of development – Summer 2010
- **<Vote>**

# ERCOT CORPORATE STANDARD

Document Name: Market Credit Risk Standard

Document ID: \_\_\_\_\_

Effective Date: Upon Approval

Owner: Board of Directors, F&A Committee

Approved:

## 1.0 PURPOSE

This Market Credit Risk Standard provides a framework by which the ERCOT Board of Directors seeks to maintain the long-term financial integrity of the ERCOT market and to help ensure that overall market credit risk is maintained within acceptable limits.

Recognizing that a number of risk factors contribute to overall market credit risk and that it is beneficial to quantify and describe these risks, a model has been developed to help evaluate the combined impact of key market credit risk factors.

~~The model objectives and parameters are outlined further in this Market Credit Risk Standard.~~

This Standard and the output of the potential credit risk model do not change collateral requirements or Market Participant obligations to comply with those collateral requirements under the ERCOT Protocols. Changes to collateral requirements require a change to ERCOT Protocols through Section 21, Process for Protocol Revision.

## 2.0 DEFINITIONS

Base Case – the Potential Credit Risk Model scenario that considers only forms and amounts of collateral required by the ERCOT Protocols.

BOD – Board of Directors

Current Case – the Potential Credit Risk Model scenario that considers forms and amounts of collateral held as of a specific point in time. This scenario may include collateral amounts above those required by the ERCOT Protocols and which may be unilaterally withdrawn at the Counter-Party's direction.

CWG – Credit Work Group

Expected Loss – the average – although not the most common – outcome across all model outcomes. It represents the loss the ERCOT market as a whole should expect to incur over time under given market conditions as a result of its portfolio credit risk.

Loss Distribution – a range of potential losses under a specific set of parameters with a given probability of occurrence

Potential Credit Risk (PCR) Model – the financial model that ERCOT uses to measure potential credit risk. It is constructed using a standard Potential Future Exposure framework that produces a portfolio Loss Distribution of potential losses.

Potential Credit Risk (PCR) Report – a report that summarizes the results from the PCR Model together with ERCOT’s analysis

Potential Future Exposure (PFE) – an estimate of potential credit risk resulting from existing counterparty relationships in light of possible future risk factors such as price volatility and volume escalation.

Probability of Default (PD) – a Counter-Party specific estimate of the likelihood that a specific Counter-Party will default over a specified time horizon

TAC – Technical Advisory Committee

### **3.0 STANDARD**

#### **Market Credit Risk Objective**

In seeking to fulfill BOD objectives to provide for a reliable Texas electricity market, ERCOT stakeholders will

- directly consider the credit implications of operational or market decisions, and
- seek to maintain a balance of identified key credit risk factors such that the combined impact of these factors yields a market-wide credit risk profile consistent with an investment grade rating

#### **Delegation of Authority**

Responsibility for monitoring and reporting on credit risk for the market consistent with this Standard is hereby delegated to the Chief Executive Officer, the Chief Financial Officer and the Treasurer. These individuals will ensure the BOD is advised of credit risk as measured by the PCR Model.



This delegation does not mean that the results of any particular model analysis will be the final determination of credit risk in the ERCOT market. Such determination rests with the BOD.

### **Internal Control**

The Treasurer will ensure that written procedures and internal controls are established over the portfolio credit risk analysis process to ensure that results are consistent with the approved process reflected in this Standard.

The Treasurer will ensure that these controls are reviewed periodically by ERCOT's Internal Audit staff to monitor compliance with control procedures. The results of Internal Audit reviews as well as underlying controls may be reviewed by the Finance and Audit Committee of the BOD upon request.

In addition, the Treasurer, in cooperation with the BOD, will seek an independent review of the PCR Model prior to incorporating the PCR Model into any determination of collateral requirements or -within one year after ~~of~~ Nodal market implementation and at least biennially thereafter.

### **Measurement**

ERCOT will use a standard Potential Future Exposure framework for measuring credit risk. The PCR Model, which was built on this framework, will be maintained within this framework.

At a minimum, ERCOT's portfolio credit risk analysis for the Zonal market will include the following risk factors:

- Probability of Default for each QSE (resulting from credit score or rating),
- Forward price analysis,
- Price volatility analysis,
- Volume escalation behavior analysis, and
- Simplified collateral calculations.

With the implementation of the Nodal market, ERCOT's portfolio credit risk analysis for the Nodal market will include the following risk factors (in addition to those outlined above):

- Price volatility analysis for the Day Ahead Market,
- Bid and offer volume analysis in the Day Ahead Market, and
- Value of Congestion Revenue Rights.

ERCOT will recommend updates of these and other risk factors if key risk factors change.

ERCOT will update model assumptions periodically with CWG input. The BOD will be informed of all model parameter changes.

At ERCOT's discretion or upon request by the BOD, TAC or CWG, ERCOT will run stress scenarios in addition to the Base Case and Current Case to quantify extreme credit risk (incorporating such things as market price events, high correlations of default, impacts of specific types of market activities and high concentration of exposures to Counter-Parties or types of Counter-Parties).

While recognizing that it is impractical to model all possible loss scenarios within the PCR Model, the PCR Model is a valuable tool to more effectively monitor credit risk within the ERCOT market. The model considers identified risk factors and provides an indication of potential losses; however, actual losses may be more or less than those indicated by the model.

### **Reporting**

ERCOT will maintain and run the PCR Model and will prepare a summary analysis of results:

1. at least quarterly, whenever ERCOT determines there have been significant changes in underlying credit risk factors which warrant a model run, and
2. upon request of TAC or CWG when contemplating market rule changes for which significant credit implications are being evaluated.

The PCR Report will, at a minimum, include:

1. the Base Case and Current Case scenarios,
2. Expected Loss, median loss and Loss Distribution at the 90, 95, 99 + percentile for required and ad hoc scenarios,
3. Large impact stress scenarios at or above the 99th percentiles and other stress scenarios
4. a listing of inputs used and assumptions made (specific, where possible; general when inputs are Counter-Party specific), and
5. ERCOT's summary analysis of the reasons for significant changes in the measurement of credit risk from the prior PCR Report.

A summary of the PCR Report will be provided to the Finance and Audit Committee of the BOD, TAC and the CWG at least quarterly.

### **Market Credit Risk Standard Adoption**

ERCOT's Market Credit Risk Standard will be adopted by resolution of the BOD. The standard will be reviewed at least annually by the Finance and Audit Committee and any modifications made thereto must be approved by the BOD.

## 8. Review The Company's Dealings With Any Financial Institutions That Are Also Market Participants – Leslie Swanson

### **Market Participant**

Bank of America, N.A.  
(also their subsidiary,  
Merrill Lynch)

JPMorgan Ventures  
Energy Corporation

### **Financial Institution**

Bank of America, N.A. or  
affiliate

JPMorgan Chase, N.A.  
or affiliate

### **Services Provided**

Lender, bank account,  
money market funds

Lender, bank accounts,  
money market funds,  
purchasing card

*Note: ERCOT's 401(k) has mutual fund options that may include securities from these or other market participants.*

9. Preapproval of Non-Audit Services From the Independent Auditor  
Mike Petterson

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**<Vote>**

**Memo attached as separate document**



**Date:** May 11, 2010  
**To:** Finance and Audit Committee  
**From:** Mike Petterson, Controller  
**Subject:** Pre-approval of engagement of external auditor for other services

**Issue for the ERCOT Finance and Audit Committee**

**ERCOT Finance and Audit Committee Meeting Date:** May 18, 2010

**Issue:**

As required by the charter of the Finance and Audit Committee, ERCOT seeks pre-approval from Committee members to engage Ernst & Young, ERCOT's independent auditor, to provide up to \$10,000 of advisory services relating to the preparation of ERCOT's 2009 IRS Form 990.

**Background/History:**

In early 2006, the Finance and Audit Committee amended its charter to include language consistent with the requirements established in Section 202 of Sarbanes-Oxley, which calls for preapproval from the Finance and Audit Committee for engagement of external auditors for "other services".

It was agreed at the time of the charter amendment that generally ERCOT staff should make the request for "preapproval" using the standard decision template (with other essential supporting documentation) used for Board and Board Committee meetings.

In 2009, the ERCOT Board of Directors selected Ernst & Young as ERCOT's external auditor and concurrently selected Ernst & Young to perform review services relating to ERCOT's annual informational tax return – the IRS Form 990.

The engagement letter relating to Ernst & Young's review of ERCOT's 2009 IRS Form 990 is specifically limited to the review of the tax forms prepared by ERCOT staff and does not accommodate tax advisory services during the preparation of the tax forms.

In 2008, the IRS adopted numerous changes to the Form 990 that significantly increased the complexity of preparing the tax form. To ensure new reporting requirements were properly and fully incorporated into its 2008 IRS Form 990, ERCOT incurred approximately \$20,000 for advisory legal services.

In connection with the preparation of its 2009 IRS Form 990, ERCOT believes it may need specialized tax advisory services and seeks pre-approval from the Finance and Audit Committee to engage Ernst & Young to provide up to \$10,000 of advisory services where necessary and appropriate. The advisory services would be discretely identified and approved by ERCOT



management before being provided by Ernst & Young personnel. The advisory services would be billed at 75 percent of the hourly rates included in the bid submitted by Ernst & Young in response to ERCOT's request for proposal for audit services.

**Key Factors Influencing Issue:**

The key factors influencing the decision are: the complexity of the 2009 IRS Form 990; expectation and necessity of full-compliance with IRS filing requirements; and the expertise of Ernst & Young tax professionals offered on an as needed basis at ERCOT's discretion.

**Alternatives:**

The F&A Committee has three primary alternatives:

1. Pre-approve management to engage Ernst & Young to provide up to \$10,000 of advisory services relating to preparation of ERCOT's 2009 IRS Form 990;
2. Pre-approve management to engage Ernst & Young to provide advisory services relating to preparation of ERCOT's 2009 IRS Form 990 up to another financial threshold acceptable to the Committee; or
3. Disapprove management to engage Ernst & Young to provide advisory services relating to preparation of ERCOT's 2009 IRS Form 990.

**Recommendation:**

Management recommends the Finance and Audit Committee pre-approve engagement of Ernst & Young to provide up to \$10,000 of advisory services relating to preparation of ERCOT's 2009 IRS Form 990.

## 10. Review the Procedures for Handling Reporting Violations

Mike Petterson

- Employees may report their concerns via a number of sources, including:
  - **Manager or Director**
  - **Human Resources**
  - **Legal**
  - **Internal Audit**
  - **EthicsPoint** (anonymous)
  - **PUCT**
  - **Board Members**
- Employees receive training to ensure they are aware of these options
- Reiterated during annual Ethics Reaffirmation process

**Q&A only**



## ERCOT Market Credit Status

as of 3/31/2010

as of 4/30/2010

### Exposure in the ERCOT Market (owed to ERCOT)

#### QSEs that meet ERCOT Creditworthiness Standards

Ratings over BBB-

	# 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-	9	39,174,190	10%	138,336,431	U	10	58,805,903	16%	149,136,588	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated										
Cash & Letters of Credit	50	208,736,940	52%	330,246,176	S	52	169,348,926	46%	321,306,822	S
Guarantee Agreements	19	155,712,204	39%	446,612,278	S	17	143,971,388	39%	427,137,410	S
<b>Total Exposure</b>	<b>78</b>	<b>403,623,334</b>	<b>100%</b>			<b>79</b>	<b>372,126,217</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-	6	(2,757,733)	-6%	73,171,790	U	6	(4,959,077)	-8%	48,326,527	U
<u>QSEs that do not meet ERCOT Creditworthiness Standards</u>										
Ratings below BBB- or not rated										
Cash & Letters of Credit	69	(29,219,476)	-59%	28,784,763	S	69	(39,267,991)	-61%	28,998,243	S
Guarantee Agreements	11	(17,787,235)	-36%	105,052,000	S	11	(20,394,133)	-32%	107,052,013	S
<b>Total</b>	<b>86</b>	<b>(49,764,444)</b>	<b>-100%</b>			<b>86</b>	<b>(64,621,201)</b>	<b>-100%</b>		

Total

164

165

U: For QSEs that meet ERCOT's Creditworthiness Standards, amount of unsecured credit granted.

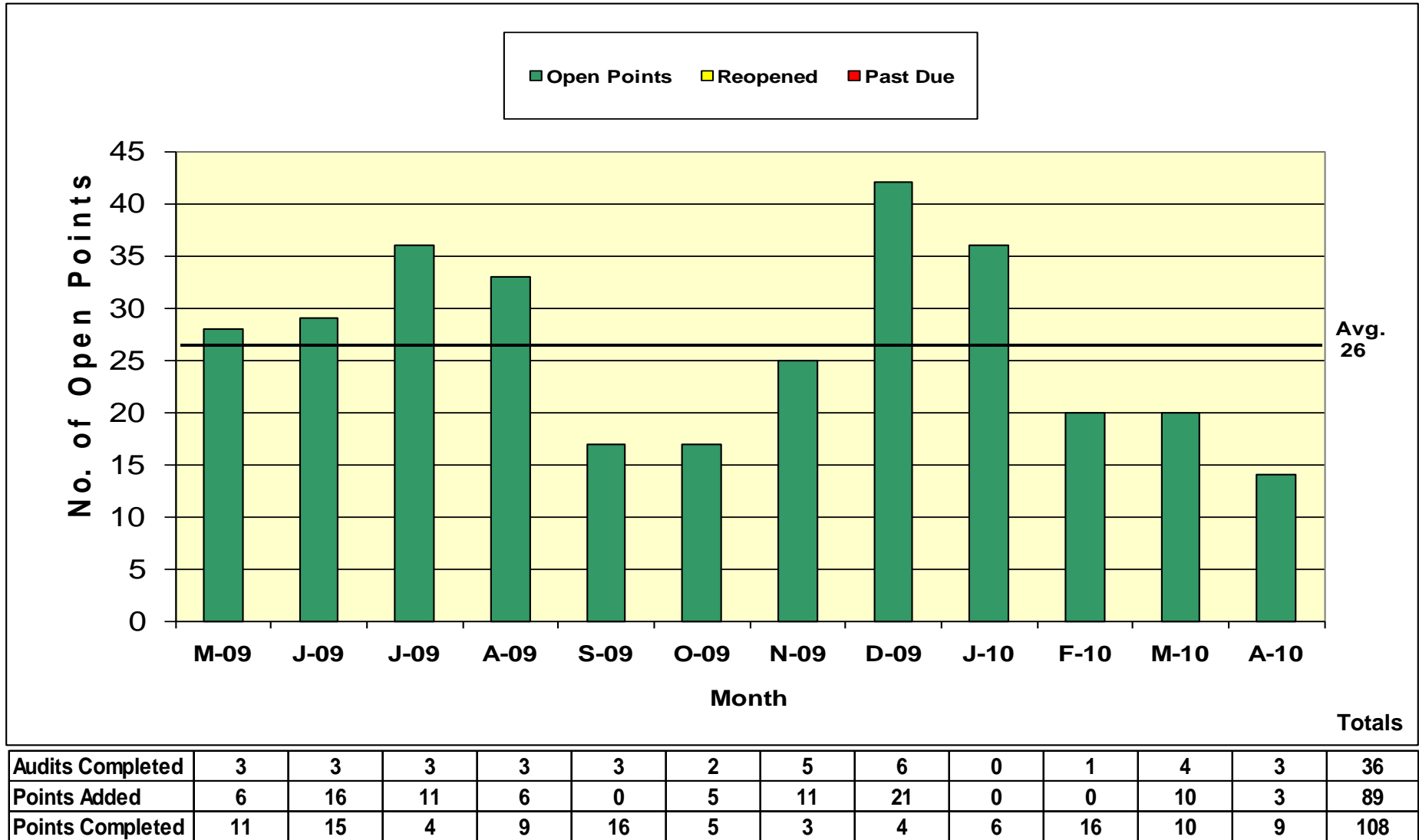
S: For QSEs that do not meet ERCOT's Creditworthiness Standards, amount of Security posted.

Note 1: Guarantee Agreements provided to meet a QSE's collateral requirements by entities that meet ERCOT's Creditworthiness Standards.

Guarantee Agreements provided to meet financial statement requirements by entities that do not meet ERCOT's Creditworthiness Standards are not included on this schedule.

# 11. Committee Brief ICMP: Status of Open Audit Points

## Cheryl Moseley



<b>Audits Completed</b>	3	3	3	3	3	2	5	6	0	1	4	3	<b>36</b>
<b>Points Added</b>	6	16	11	6	0	5	11	21	0	0	10	3	<b>89</b>
<b>Points Completed</b>	11	15	4	9	16	5	3	4	6	16	10	9	<b>108</b>

All audit points except 2 are expected to be complete by 12/31/10.

# 11. Committee Brief: ICMP – Audits

Cheryl Moseley

## Audits Completed

(last 3 months)

### Internal Audits

- FY2009 Fraud Auditing Program
- Taylor Data Center Expansion (Special Request)
- New Data Center & Control Center (Special Request)
- System Operators' Compliance with Operating Procedures (Limited Scope)
- Business Continuity Plan
- Oracle Software License Compliance (Special Request)
- 2010 Nodal Budget-to-Actual Mgmt. (Special Request – Follow-up)

### External Audits

- 2009 Financial Audit (Ernst & Young, LLP)

## Open Audits

### Internal Audits

- Renewable Energy Credits System – IT & Program Admin.
- Protocol 1.4 Required Audit – Confidentiality
- Procurement Card
- Q1 2010 Fraud Auditing
- Protocol 1.4 Required Audit – Independence Verification
- Payroll
- Nodal Program Spending (Part 1 of 2)

### External Audits

- 2010 Zonal SAS70 Audit (SAS70 Solutions, Inc.)

## Planned Audits

(next 3 months)

### Internal Audits

- Q2 2010 Fraud Auditing
- Vendor Assessments (Targeted Review)
- Cash and Investments
- Pre-Audit Testing for 2011 Nodal SAS70 Audit
- Credit Risk Model
- Patch Management and Server Hardening

### External Audits

- 2010 Benefit Plan Audit

# 11. Committee Brief: ICMP – Security Assessments

Cheryl Moseley

## Consultation/Analysis Reports Completed

(last 3 months)

### External Assessments

- Assessment of Nodal Systems

## Open Consultation/ Analysis Reviews

### External Assessments

## Planned Consultation/ Analysis Reviews

(next 3 months)

### Assessments

- 1 Security Assessment planned (Internal)

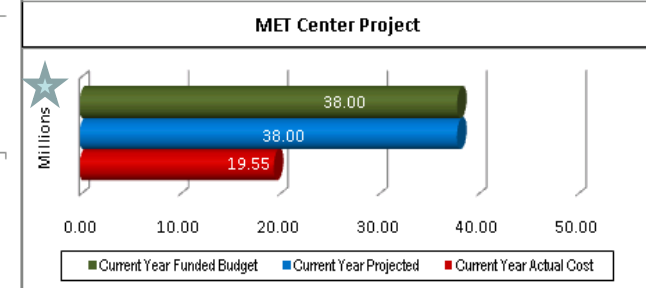
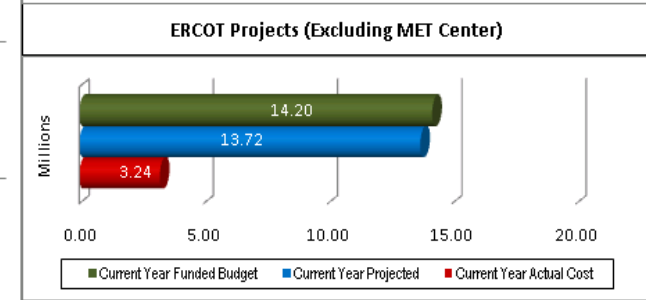
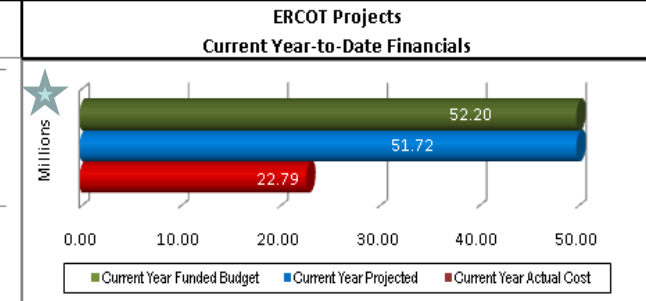
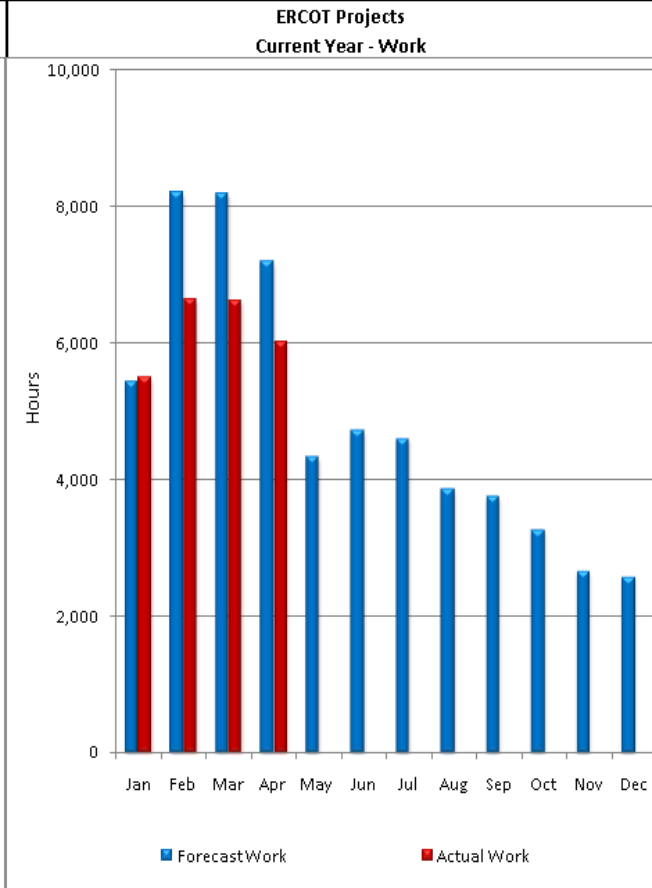
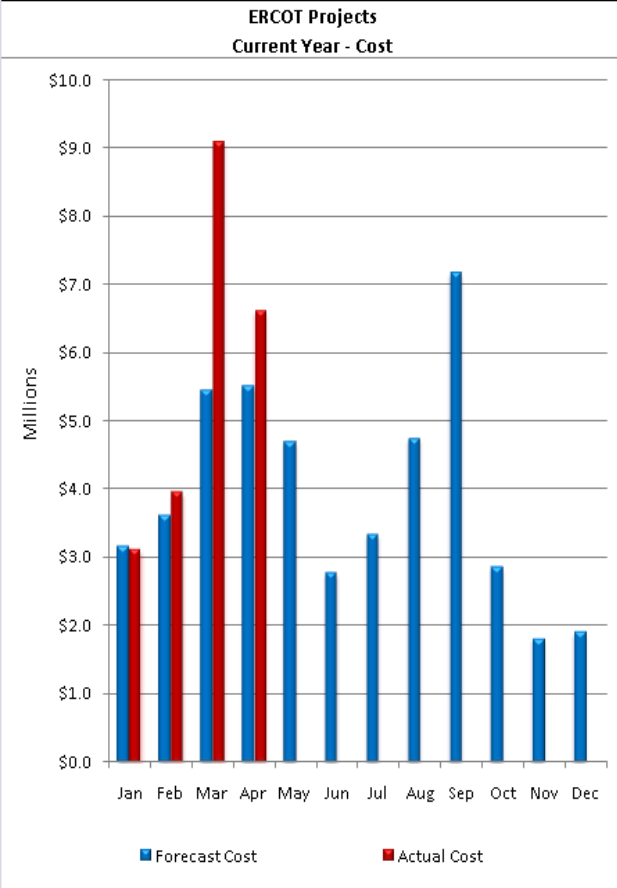
**ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.  
RISK MANAGEMENT EVENT PROFILE MATRIX (as of May 1, 2010)**

Strategic	Operational Excellence	Market Facilitation	Grid Reliability	Reporting	Legal and Regulatory Compliance
<b>Strategy Development</b> Corporate objective setting adequately incorporates informed stakeholder input, market realities and management expertise.	<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, efficient, and provide stakeholders with required assurances of quality.
<p>Strong progress made in finalizing the 5 year strategic plan. The business owners have identified initiatives that will be included in their 2010 key objectives, and are driving those initiatives into actionable items.</p>		<p>Four CRR auctions completed and settled successfully. Phase 5 testing began May 4th. Reports continue to become available as Market Trials activities ramp up. ERCOT is building an experienced market design team to review and assess design and protocol alignment with market trials results.</p>	<p>Demand for planning studies exceeds ERCOT's ability to perform them. A list of studies has been prepared &amp; reviewed, with a plan in place to conduct them. However, requests for additional studies from various stakeholders continue. ERCOT has received two awards totaling \$3.5 million to produce long-term resource and transmission planning studies in 2011.</p>		<p>Efforts underway to streamline and increase the effectiveness of ERCOT's internal controls program and integrate it with the company's Enterprise Risk Management program.</p>
<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 and operational activities are in compliance with all applicable regulatory, financial and accounting requirements, standards and directives.
<p>ERCOT is addressing reputation issues by 1) refocusing communication efforts (e.g. expanding the CEO Report to the BOD to include more details on ERCOT successes and disappointments), 2) continuing to complete Nodal on time and on budget, 3) preparing a well thought out budget for 2011, and 4) increasing accountability.</p>	<p>The 2010 YTD voluntary turnover rate as of the end of April is 2.2%. ERCOT is seeking to fill 16 full-time positions. All 16 summer intern positions have been filled with anticipated start dates in May.</p>	<p>Credit risk reflected by the PFE model has been fairly consistent for the current market over the past year and stakeholders have had the opportunity to review these results. Color remains yellow pending the review of risk factors (e.g. counterparty probabilities of default, impact of new markets and instruments, collateral levels, price volatility) in the Nodal market requested by F&amp;A.</p>	<p>December Update of the Capacity, Demand and Reserve (CDR) report forecasts reserve margins in the "out years" (2014 and 2015) to fall below the 12.5% target. The CDR report is scheduled to be updated in May.</p>		<p>ERCOT has yet to receive the confidential draft for the second part of the 2009 NERC audit. The initial TRE protocol audit report (covering Jun-07 through Feb-10 time period) revealed no protocol violations.</p>
<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.
<p>Stronger than expected energy consumption has resulted in \$0.3 million positive revenue variance through 5/2. ▾ Loads for the balance of the year are expected to be below the 2010 budget forecast, resulting in a projected revenue shortfall of \$2.6 million by end of year. ▲ However, for a number of reasons, most notably an additional \$3.2 million from The Reserve, and forecast interest expenses significantly below the budgeted amount, a year-end positive variance of \$7.2 million is currently forecasted. ▾</p>	<p>Systems remain stable in all areas. Sufficient computer room capacity for Nodal go-live and for the start of advanced metering available with the completion of the TCC1 expansion. Austin data center capacity near maximum and may not be able to accommodate additional unforeseen expansion prior to switchover to Bastrop. Capacity requirements are being closely monitored. Bastrop and TCC 3 data centers under construction; building availability by end of Q3-10, occupancy and equipment relocations in 2011.</p>		<p>There is still a lack of consensus over reactive power and frequency response requirements to existing wind generation resources. However, RTWG is planning to bring a draft of the Texas Renewables Integration Plan (TRIP) to TAC in May or June.</p>		

# 11. Committee Brief: PMO David Troxtell

## ERCOT Enterprise Projects Summary Report

ERCOT		Overall Projects Report					Reporting Period: 4/30/2010	
Projects in Ercot's Portfolio							Portfolio Performance	
Deferred	Concept	On Hold	Initiation	Planning	Execution	Closing	Schedule	Budget
0	0	1	3	5	15	3	Green	Green
			Closed	Total Active		26		
			Cancelled	Projects Not Started		2	Current Year Funded Budget: \$52,200,000	



**ERCOT**  
**Summary of Investments**  
**April 30, 2010**

(in 000's)

<u>Investment Account</u>	<u>Chase</u>	<u>Federated 068</u>	<u>Federated 0125</u>	<u>Evergreen 497</u>	<u>Invesco</u>	<u>BlackRock</u>	<u>Subtotal</u>
	<i>Treasury and Repo</i>	<i>Treasury and Repo</i>	<i>Treasury only</i>	<i>Treasury and Repo</i>	<i>Treasury and Repo</i>	<i>Treasury and Repo</i>	
Operating	\$ 8,104	\$ 5	\$ -	\$ -	\$ -	\$ -	\$ 8,109
TRE	2,657	1,267	-	-	-	-	\$ 3,925
Market	884	510	15	3,546	2,515	2,005	\$ 9,475
Deposit/Restricted	25,373	18,612	11,001	27,310	31,008	30,539	\$ 143,843
<b>Total</b>	<b><u>\$ 37,018</u></b>	<b><u>\$ 20,395</u></b>	<b><u>\$ 11,016</u></b>	<b><u>\$ 30,855</u></b>	<b><u>\$ 33,523</u></b>	<b><u>\$ 32,544</u></b>	<b><u>\$ 165,352</u></b>
% Investments:	22%	12%	7%	19%	20%	20%	100%
Other cash net of outstanding checks							<b><u>\$ (1,561)</u></b>
Total cash and cash equivalents							<b><u>\$ 163,791</u></b>

## 11. Committee Briefs: Discussion of ERCOT's IRS Form 990 Filing Mike Petterson

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- ERCOT's 2009 IRS Form 990 is expected to be filed on August 13, 2010
- Preparation and filing of the informational tax return requires ERCOT Board members and some employees to complete a questionnaire
  - The questionnaire has been distributed as part of the May board materials
  - Completed questionnaires are due on May 24, 2010
- The Board will be given an opportunity to review the final draft of the 2009 IRS Form 990 at the July 20, 2010 meeting of the ERCOT Board of Directors



## **Future Agenda Items – June 2010**

- **Standing Internal Audit agenda items**
- **Review operating plan and budget assumptions**
- **Discussion of P-card limits and the possibilities of increasing these limits for better through-put & efficiencies**
- **Assessment of compliance, the internal control environment and systems of internal controls**
- **Committee briefs**
- **Future agenda items**

# 12. Future Agenda Items: F&A 2010 Yearly Schedule

## Mike Petterson

### Quarter 1

- √ •Elect officers and confirm financial qualifications
- √ •Vote on CWG Chair/Vice Chair

### Quarter 2

- √•Report results of annual independent audit to the Board
- Review the procedures for handling Reporting violations
- √•Review results of annual audit, together with significant accounting policies (including required communications)
- Review operating plan and budget assumptions
- Review and approve Internal Audit Department Charter
- Conduct annual review of insurance coverage(s)
- Review the Company's dealings with any financial institutions that are also market participants
- Review the Market Credit Risk Corporate Standard

### Quarter 3

- Appoint the independent auditors for upcoming year
- Approval of independent auditor fees for upcoming year
- Review of committee charter
- 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

### 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 Corporate Standards
- 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 requirements for membership in CWG
- Review and approve CWG charter
- Review the Company's dealings with any financial institutions that are also market participants
- Review scope of annual financial audit
- Review of external auditor quality control procedures and independence

### 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
- Review investment results quarterly

# 13. Other Business

## Mike Petterson

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