

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Taylor TCC 2

8:00 A.M.

April 18, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at approximately 8:00 A.M. on **April 18, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present. Mr. Karnei notified the Committee that, at the request of Credit Work Group (CWG) and the Technical Advisory Committee (TAC), as a part of Agenda Item #7, CWG and TAC would brief the Committee regarding a PRR (with credit implications) that was not up for a vote at the April Board meeting.

Meeting Attendance

Committee members:

Clifton Karnei, <i>Chair</i>	Brazos Electric Cooperative	Cooperative	Present
Darrell Hayslip, <i>Vice 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
Tom Standish	Centerpoint Energy	Investor Owned Utility	Present

ERCOT staff and guests present:

Barry, Sean	PricewaterhouseCoopers
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Connell, Robert	ERCOT
Doolin, Estrellita	ERCOT
Dreyfus, Mark	Austin Energy
Garcia, Jennifer	Direct Energy
Giuliani, Ray	ERCOT (CMO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Petterson, Mike	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Walker, Mark	NRG Texas
West, James	PricewaterhouseCoopers
Wullenjohn, Bill	ERCOT
Yager, Cheryl	ERCOT

Approval of Previous Minutes

Darrell Hayslip moved to approve the Minutes for the previous regular meeting held March 17, 2005; Tom Standish seconded the motion. The motion passed unanimously.

Update on 2005 Financial Audit

Sean Barry of PriceWaterhouseCoopers (PwC) informed the Committee that he was providing the Committee with copies of financials that were substantially complete, because the audit was not yet complete.

Steve Byone explained that management was hoping to have the Committee tentatively accept the substantially complete financials immediately, with a final recommendation that the Board accept the final audited financials at the May Board meeting. Mr. Byone explained that the request for a tentative acceptance was because ERCOT was required to provide its lenders with its audited 2005 financials by the end of April.

Mr. Petterson explained the approximately \$2.8 million difference between the January preliminary 2005 year-end financial statements presented to the Committee in January, 2006 and the substantially complete audited financial statements, included the following: lower revenues (\$500,000), higher depreciation expense (\$1.1 million), higher sales tax expense accrual based upon the March 21, 2006 notification of audit results received from the Texas Comptroller of Public Accounts (\$800,000), and higher variable compensation expense accrual (\$600,000) partially offset by audit adjustments net to approximately \$200,000 lower expenses in 2005.

James West of PwC reviewed the PwC audit plan, including a summary of the mutual understanding and expectations between management and PwC, an analysis of key risks, the PwC audit approach, reporting and audit timetable and other matters. Mr. West discussed five key risk areas: (1) reserves and accruals, specifically including sales and use tax liabilities; (2) accounting for contracts with third-party vendors that provide services and software development activities; (3) management and accounting for fixed assets including physical identification and costs capitalized as fixed assets, (4) detection of fraudulent activity; and (5) evaluation and assessment of intangibles, including software amortization lives and usefulness of capitalized software costs. Mr. West confirmed that he anticipated no negative surprises from the audit, and PwC expected to provide an unqualified audit opinion.

Mr. Espinosa asked Mr. Barry whether PwC had received full support and cooperation during the audit and whether any negative issues had arisen during the audit. Mr. Barry confirmed that they had received full cooperation and support and that he did not know of any new negative issues. Mr. Espinosa asked what items remained on the audit, and Mr. Barry explained that PwC had eight or nine details remaining to complete. Mr. Espinosa stated that he wanted the Committee to have at least a telephone conference call meeting to discuss the financials before ERCOT staff released them to lenders or anyone else. Mr. Karnei stated that he would like the meeting to be on Wednesday or Thursday. Mr. Byone confirmed that he would arrange for and have notice of the meeting posted for the next week.

Mr. West confirmed that internal procedures and staffing had improved in 2005, and that their substantial testing of pre-2005 issues had reflected no major issues or difficulties. Mr. West explained that the scope of the financial audit was not intended to detect fraud, but that, because no new issues of potential fraud were noted, PwC did not need to incorporate fraud specialists into the financial audit for 2005, as had been done for the 2004 audit. Mr. Barry noted that the actual loss by ERCOT for 2005 was \$9.5 million, and the budgeted loss had been

\$15.5 million. He noted that ERCOT was in a net deficit position, with \$18 million as of December 31, 2005, as opposed to the previous deficit of \$9 million as of December 31, 2004. Mr. Barry confirmed that the ability of the organization to exist was not in doubt, that cash flows were positive, ERCOT was in compliance with all debt covenants, and he did not have any negative matters to report. Mr. Espinosa asked if ERCOT was in danger of violating any debt covenants, and Cheryl Yager confirmed that ERCOT was not. Mr. Karnei asked Mr. Barry if he had received full cooperation and support of management during the audit, and Mr. Barry stated that he absolutely had, and that the ERCOT management had a high level of ownership in the financials.

Review of Employee Conduct Documents

Susan Vincent gave an overview of the ERCOT Ethics Agreement, Code of Conduct and Fraud Prevention Standard, which were provided to the Committee, and asked the Committee members to notify Legal or Finance if they had any questions or comments about these or if the documents did not adequately reflect Committee expectations regarding employee conduct.

Review Finance & Audit Self Assessment Results

Steve Byone summarized the responses he had received from the self assessments completed by the Committee members. Survey results showed that the Committee structure, composition, and member expertise were strong and the members believed that they were kept aware of significant issues and were receiving good and sufficient information from which they could make decisions. The assessments reflected that areas for improvement included allowing more time for questions and discussion on high risk matters and more time for in-depth discussion on Internal Audit matters; continued diligence to avoid micro-managing the business; and potential educational opportunities for the members. Mr. Karnei noted that it was positive that the Committee had, for the first time, completed a self assessment which was reduced to writing. Mr. Espinosa stated that he expected the presentations before the Committee and the Board to be of "budget quality", with all loose ends completed. Mr. Karnei noted that since they frequently had packed agendas where items needed to be skipped, if anyone wanted to start earlier in the morning or to meet the afternoon before the Board Meeting, they should let him know and he would help schedule meetings as requested. Mr. Manning noted that the Committee might tend to micromanage or "drift into the weeds" on occasion. Mr. Karnei agreed but he thought that the Committee then quickly returned to the bigger picture. Mr. Karnei stated that he welcomed comments and suggestions about the agenda and the scheduling of meetings.

PMO Update

Rob Connell reviewed the organizational changes that had been implemented to the project management structure and reporting process, creating a divisional project management framework. Mr. Connell reported that three additional projects had been completed (for a total of 10 completions for the first quarter) and noted that one large project (Retail Business Processes), was ready to move into execution, would be presented in executive session to the Board. Mr. Connell reported that the Taylor Facilities Build Out for Nodal project, which had been discussed at the previous Committee meeting, had been revised to provide for finish-out of only one additional space in which to place the Nodal team. This revision in scope reduced the project below the \$1 Million threshold.

Audit Preparedness - Internal Controls

Steve Byone notified the Committee that Deloitte & Touche ("D&T") was scheduled to begin the Internal Controls Review, with testing to occur in June and July and the report expected in late July or August. Mr. Byone reported that ERCOT staff was in the final stages of implementing updated internal controls to address gaps previously identified by D&T. Mr. Byone noted that the gap remediation process was nearly complete, with certain documentation and training still required. Mr. Byone stated that he thought that, although some issues might be identified by the audit, ERCOT was in good shape and should show great improvement. Mr. Karnei asked the effective date of the audit and Mr. Byone stated that the audit would be for the period April 1, 2006 forward.

Audit Preparedness - SAS 70

Jim Brenton reported that the 2006 SAS 70 test period began April 1, 2006, and that, although the remediation of SAS 70 security items identified in 2005 audit was not fully implemented by April 1 as expected, ERCOT staff continues to actively work the remediation plan. Mr. Brenton informed the Committee that, he had implemented compensating controls pending completion of an automated solution to access control, including (a) recertifying all user access to systems (finding only 204 or less than 0.5% issues in 36,000 access points), and (b) implementing a 100% monthly audit for facility access. Mr. Brenton informed the Committee that the update of CCTV cameras and standardized server hardening had been completed; noting that layered security architecture was a significant risk mitigation measure.

Committee Brief – Enterprise Risk Management

Mr. Meek reviewed changes to the Risk Stop Light report with the Committee. Don Meek noted that the yellow status of Reputation would likely change because of the events of April 17th. Mr. Meek also noted that the Human Resources area had an increase in risk since the previous month, because of (a) issues relating to the salary freeze and other cost management directives by the PUC, which are expected to cause an overall reduction in ERCOT's ability to attract and retain quality personnel, particularly as ERCOT attempts to hire for Nodal, and (b) the loss of significant HR personnel, including the Vice President and one director. Mr. Espinosa asked what ERCOT's turnover had been. Mr. Byone stated that the turnover rate was approximately 9% and that he understood ERCOT had hired about 20 (net) people year to date. Mr. Espinosa requested that the Committee be provided the number of people hired and the number of people that had resigned, at the next meeting.

Committee Brief – Credit

Clifton Karnei confirmed that no member had questions regarding the materials presented by Credit and asked if ERCOT staff was closely monitoring credit issues, particularly given the previous day's electricity demands. Cheryl Yager responded that ERCOT continues to carefully monitor credit each day and make collateral calls as needed. Ms. Yager also noted that ERCOT had billed the first uplift from the short payments in the Fall of 2005, in the amount of approximately \$24,000.

Morgan Davies, CWG Chairman, and Mark Dreyfus, TAC Vice Chairman, provided the Committee with a mass transition (PRR 660) update. Mr. Dreyfus informed the Committee that, because of the potential substantial benefits to the market, TAC was seeking to authorize ERCOT to begin planning immediately for the implementation of PRR 660, even though the PRR had not yet been approved. Rich Gruber noted that beginning planning before the PRR

was approved was not in accordance with ERCOT approved procedures and explained that Texas Set needed three additional meetings to complete the requirements before detailed planning could begin. Mr. Hayslip asked when the Board could obtain the requirements and costs of the project. Mr. Gruber explained that the estimated cost of the project, subject to finalizing the requirements, was approximately \$1.5 Million, but that the project would have benefits of decreasing the time of a mass transition, decreasing credit risk, and smoothing out back office processes. Rob Connell explained that the final requirements were needed to determine the final estimate of project cost. Mr. Karnei noted that, even if the Board allowed planning work to begin on the project, since the project would likely exceed \$1 million the Board would need to vote to allow the project to begin execution.

Darrell Hayslip made a motion that the Committee recommend the Board take action to authorize planning for implementation of PRR 660 to begin, on an exception basis, even though the PRR had not yet been approved by the Board. Bob Manning seconded the motion. The motion passed unanimously.

Mr. Hayslip and Mr. Karnei reminded Mr. Davies that the CWG meetings agendas needed to be posted at least seven days in advance of the meetings, so full and fair notice was provided to all market participants and thanked the CWG for the hard and diligent work and updates.

Future Agenda Items

Mr. Byone reviewed items suggested for future Committee agendas. Mr. Hayslip requested that the Committee receive a summary of pending PUC filings.

Adjournment

At approximately 9:30 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 May 16, 2006.



Susan Vincent, Secretary