

**MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING**

Austin Met Center

8:00 A.M.

**August 15, 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 **August 15, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

**Meeting Attendance**

**Committee members:**

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Present
Miguel Espinosa, Vice Chair	Independent Board Member	Independent Board Member	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Not Present
William Taylor	Calpine Corporation	Ind. Generator	Present

**ERCOT staff and guests present:**

Anderson, Troy	ERCOT
Berinsky, Carl	ERCOT
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Davies, Morgan	Calpine
Davis, Derrick	ERCOT
Doolin, Estrellita	ERCOT
Gresham, Kevin	Reliant Energy
Gruber, Richard	ERCOT
Hancock, Misti	ERCOT
Jones, Sam	ERCOT (CEO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Paula	Public Utility Commission of Texas (PUC)
Petterson, Mike	ERCOT
Ruebsahm, Jamille	Deloitte & Touche (D&T)
Schwerdtfeger, Kathie	Deloitte & Touche (D&T)
Troxell, David	ERCOT
Uffelman, Bernard	Deloitte & Touche (D&T)
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wagner, Marguerite	Reliant Energy
Walker, Mark	NRG Texas
Wullenjohn, William	ERCOT
Yager, Cheryl	ERCOT

**Approval of Previous Minutes**

**Robert Manning moved to approve the minutes for the previous meeting held on July 18, 2006; Miguel Espinosa seconded the motion. The motion passed unanimously.**

**Reforecast of 2006 Revenues and Expenses**

Michael Petterson reviewed the reforecast of 2006 revenues and expenses including an explanation for the favorable revenue variance. Mr. Petterson explained that the Texas Nodal Market Implementation Program (TNMIP) costs were being isolated and would be covered by the surcharge recently verbally approved by the PUC. Steve Byone commented that ERCOT was committed to operating within the \$0.4054/mwh fee for base operations (not including TNMIP costs or costs attributable to Regional Entity activities), because the unbudgeted expenses (including costs of the 2006 fee case and related compensation study) were offset by the additional revenue. Clifton Karnei asked that the Committee be provided with the outside services cost of the 2006 fee case.

**Revised 2007 Budget Schedule**

Michael Petterson presented the revised 2007 budget schedule and highlighted the following items:

- Tuesday, Sept. 19 Board Agenda – Updated TNMIP resource requirements, timeline and budget.
- Tuesday, Sept. 26 Public Meeting – Preliminary 2007 Budget Presentation (facilitated by ERCOT).
- Thursday, Oct. 5 Finance & Audit Committee Special Meeting (if necessary).
- Tuesday, Oct. 17 Board Agenda – Finance & Audit Committee 2007 budget recommendation.

Mr. Espinosa confirmed with Mr. Petterson that ERCOT and the PUC were exchanging and receiving all needed information in this process.

### **Nodal Surcharge Briefing**

Steve Byone reported that the PUC had verbally approved the requested interim \$0.0663 per megawatt hour (MWh) Nodal Surcharge for the costs of TNMIP and had instructed ERCOT to send bills beginning October 1 to QSEs representing generation, based on the newly approved allocation method. Mr. Byone noted that the final order on the Nodal Surcharge was expected to be issued during one of the next two open PUC meetings. He also noted that the TNMIP financing plan would be updated after the final order was issued. Robert Manning asked if the approved interim fee would be sufficient to pay for all TNMIP costs, and Mr. Byone explained that it would not; ERCOT would require new debt to partially fund TNMIP. Mr. Byone confirmed that ERCOT still expects that approximately 40% of the funds needed for TNMIP will be obtained through the Nodal Surcharge in the development phase while approximately 60% will be funded with debt. The fact that ERCOT wants to recover costs during the useful life of the assets means that the ultimate Nodal fee might need to be higher than the interim fee. Mr. Byone confirmed to Mr. Manning that ERCOT did not expect to request a higher *interim* fee. The committee asked that a high-level estimate of the expected final surcharge (incorporating updated TNMIP budget projects) be provided at the September meeting.

### **Discussion of Materiality Level**

Michael Petterson explained that ERCOT would benefit from having a clear statement of materiality, so that it could set the appropriate level of and efficiently scope its internal controls. Mr. Petterson provided rationale, support, and background for management's conclusions regarding the type and size of transactions recommended to be considered material to ERCOT's financial statements. Mr. Petterson explained that the materiality threshold had a cost impact on a company, since it drove the costs of compliance, and that other companies were looking at this issue for Sarbanes Oxley compliance. Steve Byone confirmed that PwC was in support of ERCOT (with support of the Committee and Board) establishing a materiality threshold to aid the company in establishing its controls, and stated that he believed PwC would continue to establish its own materiality level to use during ERCOT audits. Mr. Byone agreed to try to obtain more information about the level of materiality used by other ISOs and to ask PwC to attend an upcoming Committee meeting, so that the Committee could further discuss this topic. Mr. Byone assured the Committee that in the event materiality levels were adopted, ERCOT would remain committed to striving for zero errors and was only seeking the threshold to help focus internal control activities. Mr. Karnei stated that the Committee did not condone sloppiness or errors of any kind, and he requested that ERCOT prepare a statement embodying this general concept to go along with a materiality statement for consideration by the Committee. Mr. Espinosa also confirmed with Mr. Byone that materiality regarding fraudulent conduct would be very different from the general materiality threshold and that a zero tolerance for fraud would remain in place at ERCOT. Bill Wullenjohn stated that establishing materiality levels would not impact the internal audit program and confirmed that internal audit would continue to investigate seemingly small issues if fraud were suspected.

### **Project Priority List/Funding Level**

David Troxtell presented the 2007 Project Priority List with detailed information for each of the five operating areas (i.e. Corporate Operations, IT Operations, Market Operations, Retail Operations, and System Operations). Mr. Troxtell explained that, for the first time, capital projects of \$36 million, which was \$11 million increase from the previous two years, had been requested and approved by PRS and TAC. Mr. Karnei noted that the previous project threshold of \$25 million had been an arbitrary figure that had been adopted, and the Committee had asked that TAC and PRS review the requested project list without an artificial limitation for 2007.

Kevin Gresham, Chair of PRS, described the process used by PRS and TAC to prioritize projects indicating that a much more vigorous vetting process had been used for 2007 relative to previous years. Mr. Gresham also explained that all projects that would be made irrelevant by TNMIP had been eliminated from the list. Mr. Troxtell confirmed to Scott Gahn that the primary areas requesting a spending increase were Corporate (primarily Security) and IT Operations.

Mr. Troxtell explained that, because (1) the requested project level was \$11 million greater than 2006, (2) the current budget assumption was that the 2007 system administration fee would remain flat, and (3) ERCOT's current debt ratio assumption is 40/60, equating to a demand of \$4.4 million on general revenue, ERCOT proposed that the Committee consider one of four 2007 budget options:

- Permit all projects, retain debt restrictions, keep fee flat and cut \$4.4 million in other ERCOT services
- Permit all projects, retain debt restrictions and increase fee by \$4.4 million (~\$0.015)
- Permit all projects, keep fee flat and change debt ratio from 40/60 to 28/72
- Reduce the projects to 2006 levels (~\$25 million)

The Committee discussed the options in detail, noting that ERCOT could not realistically cut \$4.4 million from its general operations, since large cost cutting had already occurred in 2005 and 2006. William Taylor asked if ERCOT staff would realistically be able to complete this level of projects during 2007, given all demands on personnel. Mr. Troxtell stated that the project staff believed that it could complete this level of projects, but Mr. Byone stated that the Executive management team was continuing to analyzing ERCOT's ability to complete \$36 million in projects. Mike Espinosa and Clifton Karnei suggested that the Committee consider the budgets for base operations and TNMIP before making a decision about which option to adopt, but indicated support to either request an increase of the fee if all projects were necessary or to increase the permitted debt ratio, if management determined the level of projects could be completed.

#### **Audit Status Briefing (Internal Controls/SAS 70)**

Steve Byone reported that Deloitte & Touche was continuing their work with ERCOT regarding Internal Controls and that their final report was expected in November. Kathie Schwerdtfeger of D&T commented that D&T auditors were generally pleased with the design of the control framework but had identified opportunities for ERCOT personnel to be more efficient and to better document items for testing. She also mentioned that she was in support of the "materiality" approach recommended by management. Byone also reported that initial SAS 70 testing had been completed by PwC and that further remediation work was required in the Logical Security area.

#### **Audit and Compliance, Incidence Response Preparedness and ERM Update**

Steve Byone made reference to the materials that would be presented to the full Board and offered Committee members the opportunity to make comments and ask questions.

#### **Credit**

Morgan Davies made reference to the materials that would be presented to the full Board and offered Committee members the opportunity to make comments and ask questions. Mr. Byone informed the Committee that Mark Armentrout had requested the Committee be prepared to inform the Board of its recommendation regarding next steps on credit. The Committee members discussed in detail the work that the TAC, PRS, and the Credit Working Group had

put into improving credit risk. Clifton Karnei noted that, with the reduction in the timeline for Mass Transition, the compromise PRR in process, and the on-going analysis of credit insurance, the Committee would seek feedback from the Board regarding what further steps the Board expected from the Committee. Scott Gahn stated his belief that the Committee had done sufficient work on credit matters, and that PRS and TAC should be provided time to review the proposed PRR through the normal stakeholder process. Given the discussion, Mr. Karnei suggested that the Committee monitor the progress of the PRR in process, continue to pursue credit insurance and continue to monitor credit issues. Mr. Karnei asked that the Committee's proposed course of action, as discussed, be reduced to writing to be reviewed at the next Committee meeting.

### **Committee Briefs**

#### **Risk Management Event Profile Matrix**

Don Meeks reviewed the Risk Management Event Profile Matrix, and Mr. Byone and Mr. Meeks highlighted changes which had occurred since July.

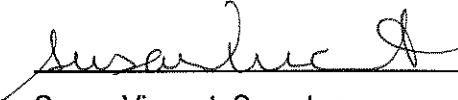
### **Future Agenda Items**

Steve Byone reviewed with the Committee the following as agenda items for September:

1. Texas Nodal Market Implementation Program
2. 2007 Budget Status Report
3. 2006 Project Delivery Checkpoint
4. Annual Benefit Plan Audit
5. Options to Increase Liquidity

### **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 September 19, 2006.

  
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Susan Vincent, Secretary