

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center

7:30 A.M.

February 21, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:30 a.m. and immediately retired for a closed executive session regarding personnel matters, until approximately 8:10 a.m. The Committee reconvened at approximately 8:15 for the open public session. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, <i>Chair</i>	Brazos Electric Cooperative	Cooperative	Present
Darrell Hayslip, <i>Vice Chair</i>	Calpine Corporation	Ind. Generator	Not 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
Ettorre, Ed	ERCOT
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Geoff	ERCOT
Petterson, Mike	ERCOT
Schwerdtfeger, Kathie	Deloitte & Touche
Sundhararajan, Srin	ERCOT
TroxteLL, David	ERCOT
Uffelman, Bernie	Deloitte & Touche
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
West, James	PricewaterhouseCoopers
Yager, Cheryl	ERCOT

Approval of Previous Minutes

Bob Manning moved to approve the Minutes for the previous regular meeting held January 17, 2006; Tom Standish seconded the motion. The motion passed.

Finance & Audit Committee Charter

Bob Manning moved to approve the recommended changes to the Committee Charter that had been discussed at the previous Committee meeting. Tom Standish seconded the motion. The motion passed.

Audit Planning

1. 2005 PwC Financial Audit

Sean Barry and James West of PriceWaterhouseCoopers (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/ 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.

1. Benefits Plan Follow-up

Steve Byone provided a brief update on Nancy McIntire's behalf and noted that ERCOT was doing everything possible to resolve issues identified prior to 2006 and that management could not say with certainty that there would be no issues identified in 2006. He noted that corrections of prior years were still in progress and since these were affected in 2005 and 2006 the results for 2005 and 2006 would be impacted. Mr. Byone informed the committee that more information would be shared during the Board retreat and at Committee meetings over the course of 2006 as any additional issues were identified.

2. SAS 70

Steve Byone and Jim Brenton updated the Committee on specific actions management had taken and was in the process of taking to prepare for the 2006 SAS 70 audit including (1) assembly of SAS 70 Readiness Team, (2) user provisioning for cyber and physical security, (3) hardening standards for cyber security, and (4) closed circuit television in digital format for physical security. Mr. Brenton explained that, until ERCOT was able to have an automated logical security system in place, security would do an annual 100% manual recertification of logical access.

3. Internal Controls Assessment

Steve Byone informed the Committee that management and the PUC staff were working together to develop plans to conduct a third party follow-up review of progress on internal controls. The review will be performed during the summer and findings would be available by late August 2006. Mr. Byone informed the committee that due to a combination of an increased scope in work and a need to make the review findings publicly available there would be an increase in cost relative to the estimate previously provided and included in the budget.

4. Sales Tax Audit

Mike Petterson reported to the Committee the results of the sales and use tax audit conducted by the Comptroller of Public Accounts beginning in April 2005, for the period 2001 – 2004 and described management's plan to challenge the proposed \$2.6 million liability, which was \$600,000 more than ERCOT accrued as of December 2004. Mr. Petterson explained that the discrepancy between the proposed liability and the amount accrued by ERCOT was due to the Comptroller's reliance on a recent, unpublished interpretation which generally expands the type of third-party software consulting services that are subject to Texas sales and use tax. He also informed the Committee that ERCOT may pay the proposed sales tax liability to stop additional interest and penalties from accruing during the hearing and appeal process.

Large Projects Briefing

Mr. Connell noted that three projects were completed in January and that 4 large projects, 2 of which would be presented to the Board in Executive Session for approval, later in the day.

Finance Update

1. Early Debt Retirement

Cheryl Yager informed the Committee that because the TCR revenues were higher than expected and ERCOT can borrow against TCR revenues at a lower rate, management intended to prepay the November 1, 2006 Term Loan payment. Ms. Yager explained that she expected that this payment would be made at the end of February and that the cost savings obtained were expected to total between \$16,000 and \$33,000.

2. Nodal Financing Discussion

Cheryl Yager reminded the Committee that the working estimate of Nodal Market Redesign cost was approximately \$125 Million, and that, at the Committee's request, management had discussed methods to fund the Nodal Market Redesign efforts. Ms. Yager informed the Committee that management proposed collecting revenues early and funding with a blend of revenue and debt. Ms. Yager proposed that ERCOT would request a separate fee for the \$125 Million, spread over 7 years (the construction period plus the useful life of the hardware and software), and that she estimated the revenue requirement would be between 6 and 6.5 cents per MWH, given those assumptions. Clifton Karnei mentioned that the Committee wanted to review some ideas for funding, so they could consider whether to "front load" the funding to cover developmental costs as they are incurred or "back load" the funding to match funding with the anticipated benefits from Nodal. Mr. Byone informed the Committee that based upon the November letter to the PUC, ERCOT had begun spending on Nodal, and he anticipated that a filing would need to be made to bring the funding matter before the Commission prior to the next committee meeting.

Tom Standish asked Ms. Yager what the useful life of the items purchased for \$125 Million would be, and she responded that the hardware and software would have a life of 3 to 5 years. Mr. Standish suggested that the Committee should consider accruing money for long-term depreciation and upgrades. Mr. Standish asked that the cost over the long-term be looked at, to ensure that all people benefiting would pay their fair share. Mr. Karnei reminded the Committee that, regardless of the initial method of funding, there would need to be period review of the cost allocation and payment. Ms. Yager noted that ERCOT needed to consider overall debt as well as the timing of payments for the Nodal effort. Mr. Standish indicated that users down the road could pay for the benefits of Nodal, and the debt level could still be reasonable, but Mr. Byone mentioned that, because ERCOT doesn't have any tax incentive to carry debt, the high cost of

carrying debt must be considered. Mr. Byone suggested that by requesting PUC action regarding needed funding an official process to obtain input from the market could be started.

Scott Gahn asked if the Committee needed to approve the filing for the Nodal funding, and Mr. Karnei responded that it was still being researched, but that, in any case, for governance purposes, the Committee would like to see the options for funding that would be filed, so that the members could give comments before the filing was made. The Committee discussed whether one funding recommendation or various methods of possible funding should be filed. Mr. Mann recommended that ERCOT present options for funding, with the implications of each method listed. Mr. Byone informed the Committee that ERCOT could recommend methods of financing, but would not recommend who would pay or how the fee should be assessed among market participants.

Credit Statistics

Ms. Yager informed the Committee that PRR 638, which has a positive credit impact, because it shortens the invoice payment cycle from 16 days to 5 business days, would be before the Board for a vote, later in the day.

F&A Committee Self Assessment

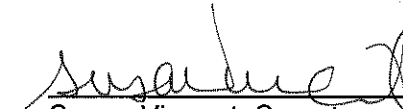
Mr. Karnei noted that the F&A Committee self assessment document presented by Mr. Byone was the first written assessment that they had received. Mr. Karnei told the Committee that if any member had any additional questions that he wanted to add, he should send the question to Mr. Byone, who would add the questions and send out the final self assessment document. Mr. Karnei asked each member to complete the self assessment and told them that Mr. Byone would tabulate the results for review at the next meeting.

Future Finance & Audit Committee Meeting Agenda Items

Mr. Byone reviewed the list of potential future Committee agenda items with the Committee. Mr. Karnei noted that he would not be available to be at the March 21st meeting in person, so he asked if Bob or Mike could chair if Darrell was not available.

Adjournment

The meeting was adjourned at approximately 9:29 a.m., and the Committee went into Executive Session. The next meeting will be held on the morning of Marcy 21, 2006.



Susan Vincent, Secretary