

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Met Center
8:00 A.M.
January 17, 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 **January 17, 2006**. 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	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 (via telephone)	PricewaterhouseCoopers
Byone, Steve	ERCOT (CFO)
Connell, Robert	ERCOT
Doolin, Estrellita	ERCOT
Ettorre, Ed	ERCOT
Giuliani, Ray	ERCOT (CMO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Petterson, Mike	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Yager, Cheryl	ERCOT

Clifton Karnei called the meeting to Order at 8:00 am and welcomed Tom Standish and Scott Gahn as new Committee members.

Approval of Previous Minutes

Mike Espinosa moved to approve the Minutes for the previous regular meeting held **December 13, 2005**; **Darrell Hayslip** seconded the motion. The motion passed.

Election of Committee Chair and Vice Chair

The Committee members discussed the Chair and Vice Chair positions and the Committee's desire to have the current Chair and Vice Chair continue. **Mike Espinosa moved to have Clifton Karnei named Committee Chair. Bob Manning seconded the motion. The motion passed. Mike Espinosa moved to have Darrell Hayslip named Committee Vice Chair. Bob Manning seconded the motion. The motion passed.**

Finance & Audit Committee Charter Review

Mr. Karnei reminded the Committee that it needed to do an annual review of the Committee Charter. The members reviewed and discussed the Finance & Audit Committee Charter dated July 8, 2003. The members agreed that, because the Board currently had only one member from each Segment, the original Charter requirement that each Segment must be represented on the Committee was unworkable, since the HR & Governance Committee meets at the same time and Finance & Audit Committee. Tom Standish suggested that the Committee should have a split between Segment members and independent members, and Mr. Hayslip suggested that the Committee should have at least 5 members.

The members also discussed the requirement that at least one Committee member have past employment experience in finance or accounting and/or professional certification in accounting or other comparable experience or background. The members noted that Mr. Espinosa had significant finance experience, and Mr. Karnei was a CPA with accounting experience and had significant financial oversight responsibilities, thereby providing the Committee with sufficient financial expertise and sophistication.

The Committee voted to amend the Charter, to correct the number of members required from the Segments. **Mr. Espinosa made a motion to amend the first sentence of the Charter to read as follows:**

"The Finance and Audit Committee of the Board of Directors of ERCOT (the "Committee") shall be comprised of five board members with at least three members from Market Segments, as defined in the Bylaws as well as one or more of the Independent Board members of ERCOT (the "Company")."

Mr. Manning seconded the motion. The motion passed.

The Committee determined that it would ask the Board to vote on the Committee's recommended modifications to the Finance & Audit Committee Charter at the February Board meeting. The Committee further determined that Susan Vincent would be its designated secretary at its meetings. The Committee also discussed doing an additional evaluation of the Committee's performance. Mr. Byone offered to bring suggested additional evaluation materials to the next Committee meeting.

Audit Report Acceptance

Mr. Byone formally requested that the final Benefit Plan Audit, which had previously been provided to the Committee and the Board, be accepted by the Committee. Sean Barry discussed the details of the audit findings, noting that the final paragraph of the audit contained the discussion of certain non-compliant transactions that had been previously discussed by the Committee and for which corrections had been made by ERCOT. Mr. Barry noted that the audit had been a very comprehensive review of all details of the benefits plans. Mr. Espinosa noted that the Committee wanted ERCOT to have a sense of urgency regarding all audit issues in 2006, and the Committee required any remaining items or errors be corrected immediately. Mike Petterson explained that the errors noted in the audit were from the period 1999-2004. Mr.

Petterson explained that, although he did not anticipate any new issues from 2005, because the correction of the previous errors occurred in 2005, the disclosure of the previous errors would be included in the upcoming 2005 audit, as well.

Mr. Espinosa moved that the Benefit Plan audit be accepted. Mr. Manning seconded the motion. The motion passed.

Committee Briefs

- 1. Enterprise Risk Management Update.** Don Meek provided an overview of the updated ERM spotlight report, noting that the significant changes related to the failure in the retail transaction system over the holidays. Mr. Meek confirmed that significant efforts were underway to repair the relevant hardware and the ERCOT communication systems. Mr. Espinosa asked if the PUC's primary concern was regarding the communications, and Mr. Byone confirmed that the PUC was concerned about prompt disclosure processes. Mr. Manning and Mr. Karnei suggested some modifications to the appearance and clarity of the chart, including a reversal of the arrows, so that the arrow direction would reflect the risk direction. Mr. Meek explained that a number of management risk reduction initiatives were underway, and that the risk management committee was now meeting monthly to discuss and have managers explain issues in their areas.
- 2. Internal Control Management Process (ICMP) and Audit Point Status.** Cheryl Moseley reported significant progress in addressing gaps, and stated that of the 288 audit points, an additional 47 went into execution in December, a total of 241 were complete, and 223 of the completed points had been verified by the end of December. Ms. Moseley explained that an additional 18 new audit points were added in December (giving a total of 306 audit points), and that these 18 additions were in the planning phase. Ms. Moseley reviewed the materials detailing the ICMP progress and noted that 83.68% were complete and of these 92.53% was verified by the end of 2005.
- 3. Credit Statistics.** Cheryl Yager explained that there was no significant change in credit issues or exposure in December, and she gave an overview of the 2 PRRs with Credit implications that were going before the Board for a vote – PRR 625 and PRR 646. Ms. Yager noted that TAC had taken a different position than the Credit Work Group (CWG) on PRR 646, requesting a (\$1,000) floor for bidding by a Load acting as a Resource, rather than the CWG's recommendation of a \$0 floor. Mr. Karnei, Mr. Hayslip and Mr. Espinosa discussed whether the Committee should take a position on PRR 646, since the TAC recommendation was contrary to the CWG recommendation that would prohibit negative bids. Mr. Manning suggested that the issue be reframed clearly for the Board, since the Board members' fiduciary obligations would require them to close any loopholes and could require them to prohibit negative bids. The Committee determined that it should listen to the TAC rationale before taking a position as a Committee on the PRR. Ms. Yager noted that the major credit issue was mass transition, and that she would discuss this issue at a future Committee meeting.
- 4. Large Projects/PMO.** Rob Connell noted that 67% of the projects on the original 2005 PPL were executed, completed, or cancelled in 2005. Mr. Karnei noted that it appeared that ERCOT had only completed 54% of the 2005 projects (62 of 115), but Mr. Connell explained that 40 projects were added during the year, and of the 109 original projects, 55 were completed and 15 canceled for the 67%. Mr. Connell informed the Committee that all of the Project Management staff was PMP certified and it was doing a very good job. Mr. Manning asked if the staff was using the PMP methodology, and Mr. Connell explained that they are following PMP methodology and are monitoring our capability maturity model, but that they needed to formalize risk mitigation strategies and quality assurance. Mr. Connell gave an overview of 5 large projects. Mr. Connell confirmed to

Mr. Espinosa that the large projects do not include functionality that will be replaced by market redesign initiatives.

Quarterly Investment Performance Review

Ms. Yager gave the Committee an overview of the quarterly investment performance for the 4th quarter of 2005 and confirmed that ERCOT was not investing funds in any financial institutions that were market participants. Ms. Yager reviewed with the Committee major requirements of the Investment Policy and the related investment processes and noted that most ERCOT funds were invested in money market mutual funds. Scott Gahn asked what ERCOT would do if its investment risks increased as a result of ERCOT being unable to invest in financial institutions that were also market participants. Ms. Yager explained that there was unlikely to be noticeably increased risk due to the nature of money market mutual funds, however, ERCOT may earn lower rates of return since there would be fewer funds to choose from, and she mentioned that the Committee would be able to monitor this each quarter. Mr. Yager confirmed to Mr. Gahn that money earned on investments (other than security deposits) was retained by ERCOT to meet its operating needs. Interest earned on security deposits is credited to the market participant for whom the security deposit was held... Ms. Yager explained that because Barclay's had recently filed an application to become a market participant, in January 2006 ERCOT moved its investment funds from Barclay's Global Investor funds to The Reserve Fund family of funds.

Preliminary 2005 Budget Variance

Mike Petterson reminded the Committee of their previous discussions about application of the 2005 budget variance. The following actions are under consideration: (1) apply funds to temporarily fund Nodal (market redesign) costs and (2) apply the balance to reduce the debt from 2005 capital projects. Mr. Petterson informed the Committee that preliminary, unaudited financial results indicate fiscal year 2005 ended with a \$10.1 million favorable budget variance. Mr. Hayslip noted that the Committee should consider whether using the money for market redesign first would be the correct application or if this might provide the appearance that the market redesign was less costly. Mr. Karnei informed the Committee that, in response to ERCOT's letter to the PUC, requesting the ability to begin to pay for initial market redesign costs, the PUC had indicated that they preferred that the budget variance be used to pay for initial market redesign costs. Mr. Hayslip questioned how the money should be divided between market redesign and repayment of debt. Mr. Espinosa stated that the repayment of debt and incurrence of new debt should be a cash management issue for ERCOT. Tom Standish noted that, if debt costs increased over the next year, ERCOT would want to consider using the budget variance rather than incurring new, more expensive debt.

Mike Espinosa moved that the Committee recommend that the Board direct ERCOT staff to apply any favorable budget variances from the 2005 budget year to (1) temporarily fund initial costs incurred in 2006 for the wholesale market redesign and (2) to the extent available, reduce outstanding debt or reduce debt funding of 2005 projects. Darrell Hayslip seconded the motion. The motion passed.

Overview of Corporate Policy Framework


Mr. Karnei noted that discussion of the Corporate Policy Framework was moved to the February meeting.

Future Finance & Audit Committee Meeting Agenda Items

Mr. Byone informed the Committee that future Committee agenda items included ABC Objectives & Timeline, PricewaterhouseCoopers Audit Plan, Scope of Third-Party Internal Control Review, SAS 70 Unqualified Opinion Planning, Revised capital project prioritization criteria, Review Credit Working Group Charter (in February or March), Fee Filing Update, Committee Briefs, Investments and Corporate Veil issues.

Adjournment

At approximately 9:25 a.m., the meeting was adjourned and the Committee went into Executive Session. The next meeting will be held on the morning of February 21, 2006.



Susan Vincent, Acting Secretary