



# **Item 12.1: Review Unaudited 2012 Financial Statements**

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**Finance & Audit Committee Meeting**

**ERCOT Public**

**March 18, 2013**

**Statements of Financial Position with Fluctuation Analysis**

As of December 31, 2012 and 2011

(Dollars in Thousands)

All changes greater than \$750 are explained below

	2012	2011	\$ Change	% Change	Variance Explanation
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	\$ 319,262	\$ 246,803	\$ 72,459	29.4%	Increase primarily related to the following: 1) Cash related to the market increased by \$33.4M 2) Increase of (\$10.0M) in CRR borrowings in 2012 3) Lower level of outstanding checks of \$0.5M in 2012 4) Increase of \$28.6M in operating accounts based on business needs
Accounts receivable	3,865	9,498	\$ (5,633)	-59.3%	Decrease related to a change in the timing of bill cycles. In November 2012, ERCOT changed its billing cycle from once a week to every weekday. Therefore, there are fewer invoiced days billed but not received at the end of each month. In 2011, there were 14 days in accounts receivable, compared to 5 in 2012.
Unbilled revenue	6,368	10,111	\$ (3,743)	-37.0%	Decrease related to a change in the timing of bill cycles. In November 2012, ERCOT changed its billing cycle from once a week to every weekday. Therefore, there are fewer days left unbilled at the end of each month. In 2011, there were 16 days in unbilled revenue, compared to 9 in 2012.
Restricted cash	471,876	413,884	\$ 57,992	14.0%	Restricted cash relates to security deposits held. Additional collateral was collected for the 2013 annual CRR auction held in November 2012, and the 2014 annual auction held in December 2012.
Prepaid expenses and other current assets	14,970	18,265	\$ (3,295)	-18.0%	Decrease in prepaid expense is primarily related to the amortization of large prepaid invoices covering multiple years that were added in 2011: 1) In 2011, ERCOT paid Hitachi Data Systems for 2012-2013 hardware and software support as well as professional services through 2015. The unamortized balance as of 12/31/2012 is \$1.3M. 2) In 2011, ERCOT paid Prism Innovations for SMARTnet maintenance through 2014. The unamortized balance at 12/31/2012 is \$0.8M.  The amortization of these invoices, along with the continued amortization of all other prepaid items is slightly off-set by prepaid invoices that were added in 2012.
Total current assets	816,341	698,561			
Property and equipment, net	288,213	376,601	\$ (88,388)	-23.5%	Decrease related to the following: - Continuing depreciation of the Nodal software that was added in 2010 of (\$69.1M). - Continuing depreciation of other assets (\$33.7M). - Net asset additions of \$14.4M, primarily consisting of the capitalization of the data center project, data center hardware, and post Nodal go-live software.
Systems under development	10,025	9,859	\$ 166	1.7%	
Debt issuance cost	560	327	\$ 233	71.3%	
Total assets	1,115,139	1,085,348			

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	2012	2011	\$ Change	% Change	Variance Explanation
<b>Liabilities and Unrestricted Net Assets</b>					
Current liabilities:					
Accounts payable	2,177	8,529	\$ (6,352)	-74.5%	Decrease primarily due to the following: - (\$3.3M) decrease due to the payment of the quarterly NERC assessment fee in December 2012. The 2011 invoice was outstanding as of December 2011. - (\$1.7M) decrease due to the payment of property taxes related to the Taylor facility. This expense was outstanding in December 2011, but was paid early in December 2012. - (\$0.9M) decrease related to the timing of receipt of and payment for invoices related to prepaid software support. Prepaid invoices for software support were entered and unpaid in December 2011, compared to the related support in 2012 was either already paid for by December 2012 or the invoice wasn't received yet. - (\$0.5M) decrease due to the timing of various other invoices.
Accrued liabilities	8,247	10,253	\$ (2,006)	-19.6%	Difference primarily driven by: - (\$1.0M) decrease in accrued audit fees related to the Navigant audit that occurred in 2011 - early 2012. - (\$0.9M) decrease in CIP accrual due to the data center project. - Remaining (\$0.1M) decrease due to fluctuations in various other accruals.
Deferred revenue	3,282	3,649	\$ (367)	-10.1%	
Market settlement liabilities	330,151	296,762	\$ 33,389	11.3%	Increase of \$41.3M in CRR received (primarily due to the CRR annual auctions held in November and December 2012); decrease of (\$7.9M) in prepaids received from MP's.
Security deposits	471,876	413,884	\$ 57,992	14.0%	Security deposits held are impacted by market activity at the relevant points in time and each market participant's choice to post cash or some other form of collateral. In 2012, more cash was collected for the 2013 and 2014 annual auctions conducted in November and December (respectively).
Notes payable, current portion	17,637	164,970	\$ (147,333)	-89.3%	Decrease related to: - (\$75.0M) repayment of the 2007 Revolver. - (\$70.8M) repayment of the 2007 Term Loan - (\$5.5M) repayment of the 2008 Revolver. - \$4.0M issuance of 2012 Private Debt.
<b>Total current liabilities</b>	<b>833,370</b>	<b>898,047</b>			
Notes payable	88,630	27,267	\$ 61,363	225.0%	Increase is the net effect of paying down (\$13.6M) on the 2002 note and borrowing \$75.0M on the 2012 Private Debt.

**Statements of Financial Position with Fluctuation Analysis**

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(Dollars in Thousands)

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	<b>2012</b>	<b>2011</b>	<b>\$ Change</b>	<b>% Change</b>	<b>Variance Explanation</b>
Derivative liability	-	3,236	\$ (3,236)	-100.0%	Decreased derivative liability based on the maturity of the interest rate swaps. All swaps matured as of November 2012.
Regulatory liabilities	166,724	115,967	\$ 50,757	43.8%	Increase due to the following: - \$50.8M due to greater life-to-date Nodal surcharge collections compared to non-capitalized Nodal expenditures. From January 2012 through December 2012, ERCOT collected \$122.6M in Nodal surcharge revenues but only incurred (\$71.8M) in non-capitalized Nodal expenditures (primarily comprised of depreciation on the Nodal software assets). However, the growing liability will gradually decrease as the depreciation on the Nodal software assets continues.
Other long term liabilities	399	360	\$ 39	10.8%	
Total liabilities	1,089,123	1,044,877			
Unrestricted net assets	26,016	40,471			
<b>Total liabilities and unrestricted net assets</b>	<b>\$ 1,115,139</b>	<b>\$ 1,085,348</b>			

**Statements of Activities with Fluctuation Analysis**

For the Twelve Months Ended December 31, 2012 and 2011

(Dollars in Thousands)

All changes greater than \$750 are explained below					
	2012	2011	\$ Change	% Change	Variance Explanation
Operating revenues					
System administration fees	\$ 136,273	\$ 139,540	\$ (3,267)	-2.3%	Decrease due to decreased volume in 2012. The SAF fee remained constant from 2011 to 2012 at \$0.4171 per MWh, while the volume decreased by approximately 8M MWh. This decrease equates to a revenue decrease of \$3.3M.
Nodal implementation surcharge	122,645	125,669	\$ (3,024)	-2.4%	Decrease due to decreased volume in 2012. The Nodal surcharge remained constant from 2011 to 2012 at \$0.375 per MWh, while the volume decreased by approximately 8M MWh. This decrease equates to a revenue decrease of \$3.0M. See Amortization of regulatory asset below.
Reliability organization pass-through	13,062	11,975	\$ 1,087	9.1%	Increase due to an increase in fees billed by NERC, which in turn, was billed out to market participants.
Membership fees and other	5,275	3,429	\$ 1,846	53.8%	Increase related to the following: - \$1.1M increase related to the additional fees for processing added to WAN billing and the increased number of WAN customers. - \$0.3M increase in grant revenue received. - \$0.2M increase related to Operator and Black Start training in 2012. Operator training was previously done through Texas RE. - \$0.2M increase in revenue generated by interconnection studies.
Total operating revenue	277,255	280,613			
Operating expenses					
Salaries and related benefits	72,555	69,317	\$ 3,238	4.7%	Increase due to less capitalizable labor in 2012, as a result of the end of Nodal and Nodal Stabilization.
Depreciation	33,656	33,087	\$ 569	1.7%	
Facility and equipment costs	12,483	12,519	\$ (36)	-0.3%	
Outside services	12,220	8,367	\$ 3,853	46.0%	Increase primarily related to the following: - \$2.9M increase in contract labor and professional fees, primarily related to Nodal enhancements (as all Nodal expenses for outside services are considered O&M in 2012) and staff augmentation. - \$1.1M increase due to the Navigant audit for the Nodal program. - (\$0.2M) decrease in expenses related to training. - Increase of \$0.1M related to fluctuations in various other expenses.
Hardware and software maintenance and licensing	19,241	11,339	\$ 7,902	69.7%	Increase primarily related to the data center upgrade and post-Nodal go live as follows: - \$4.5M increase in software license purchases. - \$3.4M increase in new maintenance contracts.
Reliability organization assessment	13,062	11,975	\$ 1,087	9.1%	Increase due to an increase in fees billed by NERC.

**Statements of Activities with Fluctuation Analysis**

For the Twelve Months Ended December 31, 2012 and 2011

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All changes greater than \$750 are explained below					
	2012	2011	\$ Change	% Change	Variance Explanation
Other	6,152	5,568	\$ 584	10.5%	
Amortization of regulatory asset	122,645	125,669	\$ (3,024)	-2.4%	See Nodal implementation surcharge above.
<b>Total operating expenses</b>	<b>292,014</b>	<b>277,841</b>			
(Loss) income from operations	(14,759)	2,772			
Other income (expense)					
Interest income	3	7	\$ (4)	-57.1%	
Interest expense	(3,382)	(3,978)	\$ 596	-15.0%	
Change in valuation of interest rate swap	3,235	6,596	\$ (3,361)	-51.0%	Difference due to the maturity of the remaining interest rate swaps in 2012.
Non-operating income (expense)	428	(775)	\$ 1,203	-155.2%	The impairment of numerous software assets created a \$0.8M loss in 2011. In 2012, a gain was recorded, primarily consisting of a Hitachi rebate received and a free server and software received from IBM.
<b>Change in unrestricted net assets before deferred pension costs</b>	<b>(14,475)</b>	<b>4,622</b>			
Deferred pension costs	20	(24)	\$ 44	-183.3%	
<b>Change in unrestricted net assets</b>	<b>(14,455)</b>	<b>4,598</b>			
Unrestricted net assets, beginning of year	40,471	35,873			
<b>Unrestricted net assets, end of period</b>	<b>\$ 26,016</b>	<b>\$ 40,471</b>			