



## **Item 4.3: Review of Audited Financial Statements**

*Sean Taylor*  
Controller

Finance & Audit Committee Meeting

ERCOT Public  
April 18, 2016



# Financial Statements

Electric Reliability Council of Texas, Inc.  
Years ended December 31, 2015 and 2014  
With Report of Independent Auditors

*April 2016*



Electric Reliability Council of Texas, Inc.

Financial Statements

December 31, 2015 and 2014

**Contents**

Independent Auditors' Report ..... 1

*Financial Statements*

Statements of Financial Position ..... 3  
Statements of Activities and Net Assets ..... 4  
Statements of Cash Flows ..... 5  
Notes to Financial Statements ..... 7

PRELIMINARY AND TENTATIVE  
FOR DISCUSSION ONLY

**INDEPENDENT AUDITORS' REPORT**

The Finance and Audit Committee  
Electric Reliability Council of Texas, Inc.  
Austin, Texas

***Report on the Financial Statements***

We have audited the accompanying financial statements of the Electric Reliability Council of Texas, Inc. ("ERCOT"), which comprise the statement of financial position as of December 31, 2015, and the related statements of activities and net assets and cash flows for the year then ended, and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

The Finance and Audit Committee  
Electric Reliability Council of Texas, Inc.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ERCOT as of December 31, 2015, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Other Matter***

The financial statements of ERCOT as of December 31, 2014 were audited by other auditors whose report dated April 15, 2015, expressed an unmodified opinion on those statements.

Madison, Wisconsin  
April \_\_, 2016

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

|  | <b>December 31</b>    |                   |
|--|-----------------------|-------------------|
|  | <b>2015</b>           | <b>2014</b>       |
|  | <i>(In Thousands)</i> |                   |
| <b>Assets</b>                                  |                       |                   |
| Current assets:                                |                       |                   |
| Cash and cash equivalents                      | \$ 307,353            | \$ 314,801        |
| Accounts receivable                            | 2,259                 | 3,224             |
| Unbilled revenue                               | 2,379                 | 2,310             |
| Restricted cash and cash equivalents           | 363,549               | 409,012           |
| Prepaid expenses and other current assets      | 17,032                | 16,296            |
| Total current assets                           | <u>692,572</u>        | <u>745,643</u>    |
| Property and equipment, net                    | 99,116                | 126,546           |
| Systems under development                      | 19,359                | 20,856            |
| Debt issuance costs                            | 221                   | 244               |
| Total assets                                   | <u>\$ 811,268</u>     | <u>\$ 893,289</u> |
| <b>Liabilities and unrestricted net assets</b> |                       |                   |
| Current liabilities:                           |                       |                   |
| Accounts payable                               | \$ 3,618              | \$ 4,138          |
| Accrued liabilities                            | 8,579                 | 8,566             |
| Deferred revenue                               | 3,866                 | 4,178             |
| Market settlement liabilities                  | 356,687               | 352,819           |
| Security deposits                              | 363,549               | 409,012           |
| Notes payable, current portion                 | 4,000                 | 4,000             |
| Total current liabilities                      | <u>740,299</u>        | <u>782,713</u>    |
| Notes payable, less current portion            | 63,000                | 67,000            |
| Regulatory liability                           | -                     | 33,526            |
| Other long-term liabilities                    | 352                   | 429               |
| Total liabilities                              | <u>803,651</u>        | <u>883,668</u>    |
| Unrestricted net assets                        | 7,617                 | 9,621             |
| Total liabilities and unrestricted net assets  | <u>\$ 811,268</u>     | <u>\$ 893,289</u> |

See accompanying notes.

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets

|   | <b>Year Ended December 31</b> |                 |
|---|-------------------------------|-----------------|
|   | <b>2015</b>                   | <b>2014</b>     |
|   | <i>(In Thousands)</i>         |                 |
| <b>Operating revenues:</b>                      |                               |                 |
| System administration fees                      | \$ 162,020                    | \$ 158,741      |
| Reliability organization pass-through           | 14,704                        | 14,351          |
| Other services revenue                          | 4,287                         | 4,925           |
| Total operating revenues                        | <u>181,011</u>                | <u>178,017</u>  |
| <b>Operating expenses:</b>                      |                               |                 |
| Salaries and related benefits                   | 98,646                        | 88,813          |
| Hardware and software maintenance and licensing | 18,730                        | 16,547          |
| Outside services                                | 10,281                        | 11,901          |
| Facility and equipment costs                    | 10,279                        | 11,291          |
| Reliability organization assessment             | 14,704                        | 14,351          |
| Depreciation                                    | 55,443                        | 92,864          |
| Amortization of regulatory liability            | (33,526)                      | (66,252)        |
| Other   | 6,759                         | 6,747           |
| Total operating expenses                        | <u>181,316</u>                | <u>176,262</u>  |
| (Loss)/income from operations                   | (305)                         | 1,755           |
| <b>Other income (expense):</b>                  |                               |                 |
| Interest income                                 | 40                            | 27              |
| Interest expense                                | (2,103)                       | (2,490)         |
| Non-operating income                            | 364                           | 171             |
| Change in unrestricted net assets               | <u>(2,004)</u>                | <u>(537)</u>    |
| Unrestricted net assets, beginning of year      | 9,621                         | 10,158          |
| Unrestricted net assets, end of year            | <u>\$ 7,617</u>               | <u>\$ 9,621</u> |

See accompanying notes.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

|  | <b>Year Ended December 31</b> |             |
|--|-------------------------------|-------------|
|  | <b>2015</b>                   | <b>2014</b> |
|  | <i>(In Thousands)</i>         |             |
| <b>Operating activities</b>  |                               |             |
| Change in unrestricted net assets  | \$ (2,004)                    | \$ (537)    |
| Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities: |                               |             |
| Depreciation   | 55,443                        | 92,864      |
| Amortization of regulatory liability   | (33,526)                      | (66,252)    |
| Amortization of debt issuance costs  | 32                            | 78          |
| Net gains on capital assets  | (315)                         | (97)        |
| Changes in operating assets and liabilities:   |                               |             |
| Accounts receivable  | 965                           | (1,030)     |
| Unbilled revenue   | (69)                          | 903         |
| Prepaid expenses and other assets  | (736)                         | (6,129)     |
| Other long-term liabilities  | (77)                          | 10          |
| Accounts payable   | (149)                         | (121)       |
| Accrued liabilities  | (722)                         | (36)        |
| Deferred revenue   | (312)                         | 301         |
| Net cash provided by operating activities  | <b>18,530</b>                 | 19,954      |
| <b>Investing activities</b>  |                               |             |
| Capital expenditures for property and equipment and systems under development                            | \$ (25,842)                   | \$ (23,870) |
| Proceeds from sale of property and equipment   | 5                             | 3           |
| Net cash used in investing activities  | <b>(25,837)</b>               | (23,867)    |



Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

|  | <b>Year Ended December 31</b> |                   |
|--|-------------------------------|-------------------|
|  | <b>2015</b>                   | <b>2014</b>       |
|  | <i>(In Thousands)</i>         |                   |
| <b>Financing activities</b>  |                               |                   |
| Repayment of notes payable   | \$ (4,000)                    | \$ (17,630)       |
| Payment of debt issuance costs   | (9)                           | (4)               |
| Decrease in restricted cash  | 45,463                        | 240,105           |
| Increase in market settlement liabilities                                      | 3,868                         | 1,107             |
| Decrease in security deposits  | (45,463)                      | (240,105)         |
| Net cash used in financing activities  | <u>(141)</u>                  | <u>(16,527)</u>   |
| Net decrease in cash and cash equivalents                                      | (7,448)                       | (20,440)          |
| Cash and cash equivalents, beginning of year                                   | 314,801                       | 335,241           |
| Cash and cash equivalents, end of year   | <u>\$ 307,353</u>             | <u>\$ 314,801</u> |
| <b>Supplemental information</b>  |                               |                   |
| Cash paid for interest   | <u>\$ 2,199</u>               | <u>\$ 2,778</u>   |
| <b>Supplemental disclosures of non-cash investing and financing activities</b> |                               |                   |
| Change in accrued capital expenditures   | <u>\$ 364</u>                 | <u>\$ 1,509</u>   |
| Capitalized interest   | <u>\$ 462</u>                 | <u>\$ 473</u>     |

See accompanying notes.

# Electric Reliability Council of Texas, Inc.

## Notes to Financial Statements (Dollars in Thousands)

December 31, 2015

### 1. Organization and Operations

Electric Reliability Council of Texas, Inc. (ERCOT or the Company) is a Texas, non-profit corporation. ERCOT functions as the independent system operator for its reliability region, which comprises about 90% of the electrical load in Texas. The ERCOT region has more than 77,000 megawatts of available capacity for the summer peak demand period.

The Public Utility Commission of Texas (PUCT) has primary jurisdictional authority over ERCOT, which is responsible for ensuring the adequacy and reliability of electricity across the state's main interconnected power grid and for operating and settling the electricity markets it administers. ERCOT's market rules and operations are carried out in accordance with its Protocols filed with the PUCT. The ERCOT electric service region is contained completely within the borders of Texas, and it has only a few direct current ties across state lines to import or export power with neighboring reliability regions. ERCOT has no synchronous connections (alternating current) across state lines. As a result, ERCOT is considered "intrastate" and does not fall under the jurisdiction of the Federal Energy Regulatory Commission except for reliability issues under the provisions of the Federal Energy Policy Act of 2005.

ERCOT is governed by a Board of Directors composed of 16 directors (15 voting and one non-voting). Six of the voting directors represent segments of industry in the ERCOT electricity market, that is, cooperative, independent generator, independent power marketer, independent retail electric provider, investor-owned utility, and municipal. The remaining ten seats on the board are filled by two consumer directors (commercial and industrial), five unaffiliated directors, and three ex-officio directors, that is, the Public Counsel as a third consumer Director (residential), the non-voting Chair of the PUCT, and ERCOT's Chief Executive Officer. The six "market segment directors" and two of the consumer directors (commercial and industrial) each have an elected alternate (segment alternate) who can attend meetings and vote in the absence of the market segment director.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)

*(Dollars in Thousands)*

**2. Summary of Significant Accounting Policies**

**Method of Accounting**

The accompanying financial statements have been prepared on an accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

**Unrestricted Net Assets**

Unrestricted net assets are those that are not subject to restrictions or stipulations and that may be expendable for any purpose in performing ERCOT's objectives. Accordingly, net assets of ERCOT and changes therein are classified and reported as unrestricted net assets.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities of the financial statements and reported amounts of revenues, expenses, and capital expenditures during the reporting period. Actual results could differ from those estimates.

**Cash and Cash Equivalents**

Cash and cash equivalents consist of deposits in banks and money market investment accounts with original maturities of 90 days or less.

Cash and cash equivalents consist primarily of amounts held by ERCOT on behalf of market participants for congestion management funds and prepayments of settlement obligations (as described in Note 2 – Market Settlement Liabilities).

# Electric Reliability Council of Texas, Inc.

## Notes to Financial Statements (continued)

(Dollars in Thousands)

### 2. Summary of Significant Accounting Policies (continued)

#### Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents consist of deposits in banks and money market investment accounts with original maturities of 90 days or less.

Restricted cash and cash equivalents primarily represent amounts received for security deposits from ERCOT's market participants.

#### Accounts Receivable and Revenue Recognition

*System administration fees* – ERCOT funds its operations primarily through a system administration fee (SAF) collected from electric service providers operating within the Texas grid. This fee is charged pursuant to the ERCOT protocols and as approved by both the ERCOT board of directors and the PUCT. It is based on actual volume consumption. Revenues from the SAF is recognized in the period that the underlying energy transaction occurs. Amounts not yet billed are accrued and presented as unbilled revenue on the statement of financial position. The SAF was 46.5 cents per megawatt hour of adjusted metered load in both 2015 and 2014. It is structured to provide funding for ERCOT's core operations and related services.

*Reliability organization pass-through* – The North American Electric Reliability Corporation (NERC) invoices ERCOT for reliability functions performed primarily by Texas Regional Entity, Inc. In turn, ERCOT collects revenue from market participants for this Electric Reliability Organization (ERO) billing. The ERO billing is based on actual NERC funding, and ERCOT collects this revenue and remits it to NERC on a quarterly basis.

*Other services revenue* – ERCOT's other revenue relates to services offered to its participants, including connectivity to ERCOT's grid, wide-area network usage, training for market participants, and membership dues. Revenue related to these services is recognized either as the services are performed or at the completion of the project, assuming ERCOT has no significant continuing obligation and collection is reasonably assured. The Company does not maintain an allowance for doubtful accounts as it does not believe it has a material risk of loss associated with lack of collection. Membership dues are recognized over the membership period.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**2. Summary of Significant Accounting Policies (continued)**

**Property and Equipment**

Property and equipment consist primarily of computer equipment, software, and buildings for operations and are recorded at cost. Depreciation is computed on the straight-line method using the half year convention over the estimated life of the asset. The cost of betterments to, or replacement of, property and equipment is capitalized. When assets are retired or otherwise disposed of, the cost and related depreciation are removed from the accounts and any resulting gain or loss is reflected in non-operating income (expense) in the statement of activities and net assets for the period. The Company recognized a gain of \$315 and \$97 in 2015 and 2014, respectively, related to property and equipment. Repairs and maintenance costs are expensed when incurred.

ERCOT's depreciable lives (in years) for property and equipment are as follows:

| <u>Asset Category</u>          | <u>Depreciable Life</u>                           |
|--------------------------------|---|
| Computer hardware              | 3   |
| Software                       | 5   |
| Vehicles                       | 5   |
| Furniture and Equipment        | 7   |
| Mechanical building components | 10  |
| Buildings                      | 30  |
| Leasehold improvements         | Lesser of useful life<br>or respective lease term |

**Systems Under Development**

ERCOT continues to develop the information systems and grid operating systems that are being used in its operations. ERCOT capitalizes direct costs and related indirect and interest costs incurred to develop or obtain these software systems, about half of which are developed in connection with system development contracts with external firms. Internal costs and contract expenditures not related directly to the development of systems, and related testing activities, are expensed as incurred. Costs from completed projects are transferred to property and equipment when the systems are placed in service.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
*(Dollars in Thousands)*

**2. Summary of Significant Accounting Policies (continued)**

**Impairment**

ERCOT evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment exists, it is measured as the difference between the net book value of the asset and its estimated fair value. Impairment is computed by comparing the expected future cash flows, undiscounted and before interest, to the carrying value of the asset. No impairments requiring write-offs were identified in 2015 or 2014.

**Interest Capitalization**

Interest is capitalized in connection with the construction of major software systems, buildings, and improvements. The capitalized interest is recorded as part of the asset to which it relates and is amortized or depreciated over the asset's estimated useful life. During 2015 and 2014, capitalized interest costs were \$462 and \$473, respectively.

**Market Settlement Liabilities**

Market settlement liabilities primarily represent two types of funds held on behalf of the ERCOT market: congestion management funds and prepayments of settlement obligations. Market participant settlement amounts are collected and redistributed by ERCOT in the normal course of managing the settlement of ERCOT's markets. Such settlement obligations are generally held for less than 15 days before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**2. Summary of Significant Accounting Policies (continued)**

ERCOT manages a congestion revenue rights (CRR) program that includes monthly auctions and auctions for longer than one month. ERCOT collects and holds the proceeds from the auctions until the proceeds are distributed according to provisions of the ERCOT Protocols. ERCOT's Financial Corporate Standard, adopted by the Board of Directors, includes a provision that a certain portion of the funds held as a result of CRR auctions may be used to fund ERCOT working capital and capital expenditure needs within certain guidelines.

Market settlement liabilities consist of the following at December 31:

|                                       | <u>2015</u>       | <u>2014</u>       |
|---------------------------------------|-------------------|-------------------|
| CRR auction funds                     | \$ 293,809        | \$ 303,597        |
| Prepayments of settlement obligations | 62,878            | 49,222            |
| Total market settlement liabilities   | <u>\$ 356,687</u> | <u>\$ 352,819</u> |

**Security Deposits**

Market participants not meeting certain creditworthiness standards referenced in ERCOT Protocols must maintain a means of security with ERCOT in order to mitigate market credit risk. Market participants have discretion in the means of security, such as corporate guaranties, letters of credit, surety bonds, or cash security deposits provided the market participants remain in compliance with ERCOT Protocols. ERCOT is required to remit interest earned on security deposits to market participants.

Cash security deposits are classified as restricted cash on the Statements of Financial Position. The balance of cash security deposits is \$363,549 and \$409,012 at December 31, 2015 and 2014, respectively.

# Electric Reliability Council of Texas, Inc.

## Notes to Financial Statements (continued)

*(Dollars in Thousands)*

### **2. Summary of Significant Accounting Policies (continued)**

#### **Income Taxes**

ERCOT is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(4). The Company is also exempt from state income taxes. Accordingly, no provision for income taxes or uncertain tax positions has been reflected in the financial statements.

#### **Debt Issuance Costs**

ERCOT capitalizes issuance costs related to debt. The amounts are classified in non-current assets and amortized over the life of the debt.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No.2015-03 requiring debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from that debt liability. The ASU is effective for financial statements issued for fiscal years beginning after December 15, 2015. ERCOT will adopt the amendments in this Update in its 2016 financial statements.

#### **Financial Instruments**

The carrying values reported on the statement of financial position for current assets and liabilities and for the revolving line of credit approximate their fair values. The fair value of the Company's 3.00% senior notes payable is \$64,947 and \$70,408 as of December 31, 2015 and 2014, respectively. The fair value is estimated based on net present value calculations and quoted market prices for similar issues.

#### **Accounting for the Effects of Regulation**

ERCOT is subject to the provisions of the FASB in accounting for the effects of rate regulation. These provisions require regulated entities, in appropriate circumstances, to establish regulatory assets and/or liabilities, and thereby defer the income statement impact of certain revenues and charges because it is probable they will be recovered or repaid in future periods.



Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)

*(Dollars in Thousands)*

**3. Fair Value Measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are based on inputs of observable and unobservable market data that a market participant would use in pricing the asset or liability. The use of observable inputs is maximized where available and the use of unobservable inputs is minimized for fair value measurement. In a three-tier fair value hierarchy, which prioritizes inputs to valuation techniques used for fair value measurement, the following levels were established for each input:

- Level 1 valuations use quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date. An active market is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 valuations use inputs, other than those included in Level 1, that are observable for the asset or liability, either directly or indirectly.
- Level 3 valuations use unobservable inputs for the asset or liability. Unobservable inputs are used to the extent observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The input may reflect the assumptions of the reporting entity of what a market participant would use in pricing an asset or liability.

In the case of multiple inputs being used in a fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**3. Fair Value Measurement (continued)**

The following tables set forth by level within the fair value hierarchy ERCOT's financial assets and liabilities. The fair value on a recurring basis as of December 31 is as follows:

|                                      | 2015              |                   |             |             |
|--------------------------------------|-------------------|-------------------|-------------|-------------|
|                                      | Total             | Level 1           | Level 2     | Level 3     |
| <b>Assets</b>                        |                   |                   |             |             |
| Cash and cash equivalents            | \$ 307,353        | \$ 307,353        | \$ -        | \$ -        |
| Restricted cash and cash equivalents | 363,549           | 363,549           | -           | -           |
| Total assets                         | <u>\$ 670,902</u> | <u>\$ 670,902</u> | <u>\$ -</u> | <u>\$ -</u> |

|                            |                  |                  |             |             |
|----------------------------|------------------|------------------|-------------|-------------|
| <b>Liabilities</b>         |                  |                  |             |             |
| 3.00% senior notes payable | \$ 64,947        | \$ 64,947        | \$ -        | \$ -        |
| Total liabilities          | <u>\$ 64,947</u> | <u>\$ 64,947</u> | <u>\$ -</u> | <u>\$ -</u> |

|                                      | 2014              |                   |             |             |
|--------------------------------------|-------------------|-------------------|-------------|-------------|
|                                      | Total             | Level 1           | Level 2     | Level 3     |
| <b>Assets</b>                        |                   |                   |             |             |
| Cash and cash equivalents            | \$ 314,801        | \$ 314,801        | \$ -        | \$ -        |
| Restricted cash and cash equivalents | 409,012           | 409,012           | -           | -           |
| Total assets                         | <u>\$ 723,813</u> | <u>\$ 723,813</u> | <u>\$ -</u> | <u>\$ -</u> |

|                            |                  |                  |             |             |
|----------------------------|------------------|------------------|-------------|-------------|
| <b>Liabilities</b>         |                  |                  |             |             |
| 3.00% senior notes payable | \$ 70,408        | \$ 70,408        | \$ -        | \$ -        |
| Total liabilities          | <u>\$ 70,408</u> | <u>\$ 70,408</u> | <u>\$ -</u> | <u>\$ -</u> |

Financial assets are accounted for at carrying value of \$670,902 and \$723,813 at December 31, 2015 and 2014, respectively. Financial liabilities are accounted for at carrying value of \$67,000 and \$71,000 at December 31, 2015 and 2014, respectively.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
*(Dollars in Thousands)*

**4. Property and Equipment**

Property and equipment consist of the following at December 31:

|                                     | <u>2015</u>       | <u>2014</u>       |
|-------------------------------------|-------------------|-------------------|
| Software                            | \$ 623,065        | \$ 605,089        |
| Building and leasehold improvements | 90,569            | 90,426            |
| Computer hardware and equipment     | 85,593            | 77,740            |
| Furniture and fixtures              | 33,564            | 33,335            |
| Land                                | 947               | 947               |
| Vehicles                            | 118               | 118               |
| Construction in progress            | -                 | 116               |
|                                     | <u>833,856</u>    | <u>807,771</u>    |
| Accumulated depreciation            | <u>(734,740)</u>  | <u>(681,225)</u>  |
|                                     | 99,116            | 126,546           |
| Systems under development           | 19,359            | 20,856            |
| Total property and equipment, net   | <u>\$ 118,475</u> | <u>\$ 147,402</u> |

**5. Notes Payable**

ERCOT's notes payable consist of the following:

|                    | <u>2015</u>      | <u>2014</u>      |
|--------------------|------------------|------------------|
| 3.00% senior notes | <u>\$ 67,000</u> | <u>\$ 71,000</u> |

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)

*(Dollars in Thousands)*

**5. Notes Payable (continued)**

**Revolving Line of Credit**

ERCOT has one revolving line of credit with JPMorgan Chase Bank that was entered into in June 2012, amended in December 2013, and amended again in December 2015. This facility is primarily used for short-term working capital needs, has a maximum amount of available credit of \$125,000, and expires on December 31, 2017. As of December 31, 2015 and 2014, there was no debt outstanding under this line of credit.

The interest rate on this facility is based on the prime rate, a Eurodollar based rate, or other rate as described in the debt agreements. The contractual rate of interest on the revolving line of credit's outstanding balance was 1.03% at December 31, 2015. Additionally, at December 31, 2015, ERCOT pays a commitment fee of 0.12% on the unused portion of the \$125,000 revolving credit facility. ERCOT incurred commitment fees totaling \$152 in both 2015 and 2014, in connection with its debt facilities. The revolving line of credit has several debt covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2015 and 2014, the revolving line of credit had unamortized debt issuance costs of \$0 and \$19, respectively. ERCOT was in compliance with its debt covenants for this facility.

**3.00% Senior Notes**

On October 31, 2012, ERCOT issued \$80,000 in senior notes through a private placement. These notes bear interest at 3.00% and are due in equal quarterly principal payments beginning in December 2012 through September 2032. The private placement has several covenants, the most restrictive of which limits ERCOT's indebtedness. At December 31, 2015 and 2014, there were \$67,000 and \$71,000 outstanding senior notes, respectively and, \$221 and \$225 of unamortized debt issuance costs, respectively. ERCOT was in compliance with its covenants for these notes.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**5. Notes Payable (continued)**

**Future Maturities**

Future maturities of the senior notes are as follows:

|                          | <b>3.00%</b><br><b>Senior Notes</b> |
|--------------------------|-------------------------------------|
| Year Ending December 31: |                                     |
| 2016                     | \$ 4,000                            |
| 2017                     | 4,000                               |
| 2018                     | 4,000                               |
| 2019                     | 4,000                               |
| 2020                     | 4,000                               |
| Thereafter through 2032  | 47,000                              |
|                          | <u>\$ 67,000</u>                    |

**6. Employee Benefit Plans**

**Defined Contribution Plan**

ERCOT sponsors the ERCOT Defined Contribution 401(k) Savings Plan (the 401(k) Plan), which is subject to the provisions of the Employee Retirement Income Security Act of 1974. The 401(k) Plan utilizes a third-party administrator. Employees participating in the 401(k) Plan are fully vested after five years. Employees must be 21 years of age to be eligible to participate.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**6. Employee Benefit Plans (continued)**

ERCOT matches 75% of the employee's contribution up to 6% of eligible compensation as defined in the 401(k) Plan document. Employees are fully vested for the ERCOT match of 75% after five years. In addition, ERCOT contributes 10% of a participant's eligible compensation as defined in the 401(k) Plan document. Employees are fully vested for the ERCOT contributions of 10% after three years. Employer contributions to the 401(k) Plan are summarized in the table below:

|   | <u>2015</u>      | <u>2014</u>     |
|---|------------------|-----------------|
| 75% of the employee's contribution up to 6% | \$ 2,523         | \$ 2,333        |
| 10% of the employee's compensation          | 7,712            | 7,195           |
| Total employer contributions                | <u>\$ 10,235</u> | <u>\$ 9,528</u> |

**7. Lease and Contract Commitments**

The Company has non-cancelable operating leases and service contracts for telecommunication services, system infrastructure, and office facilities. ERCOT currently leases approximately 30,000 square feet of office space in Austin, Texas through March 31, 2022.

Minimum payments due under these commitments are as follows:

|                              |                 |
|------------------------------|-----------------|
| 2016                         | \$ 439          |
| 2017                         | 395             |
| 2018                         | 387             |
| 2019                         | 380             |
| 2020                         | 374             |
| Thereafter                   | 454             |
| Total minimum lease payments | <u>\$ 2,429</u> |

ERCOT recognized \$602 and \$850 of office rent expense in 2015 and 2014, respectively.

## Electric Reliability Council of Texas, Inc.

### Notes to Financial Statements (continued)

*(Dollars in Thousands)*

#### **8. Concentrations**

ERCOT provides reliability and market services to market participants. ERCOT settles the costs of these services by passing through the costs of such services from the providers to the users of such services. In the event that a market participant is unable to make payment on its market obligations, ERCOT's Protocols stipulate that the amount of the default is to be allocated to other market participants based on their market activity and define the allocation mechanism. In order to limit the risks associated with such occurrences, ERCOT requires a cash security deposit, letter of credit, corporate guaranty, or surety bond from market participants that do not meet certain credit standards. Credit risk related to trade receivables associated with ERCOT's fees is substantially mitigated by the fact that, by Protocol, ERCOT's fees are paid from market receipts as a first priority before any market obligations are paid.

ERCOT's fee revenue is driven by the demand for electricity rather than the number of market participants. In the event that any market participant representing load ceased to operate, another market participant representing load would assume the role in response to the demand for electricity. As such, ERCOT believes its exposure to a material reduction in revenues associated with the loss of any market participant is limited.

#### **9. Accounting for the Effects of Regulation**

##### **Texas Nodal Market Implementation Project (TNMIP)**

During 2006, ERCOT began incurring significant costs associated with the TNMIP. This project represents a market redesign and systems upgrade to improve grid reliability, increase market efficiency, and enable transparency of wholesale energy prices.

On December 1, 2010, ERCOT launched the Nodal market, which features locational marginal pricing for generation at more than 8,000 nodes, a day-ahead energy and ancillary services co-optimized market, day-ahead and hourly reliability-unit commitment, and congestion revenue rights. Based on this implementation date, TNMIP software assets of \$353,534 were placed in-service date as of December 1, 2010.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
(Dollars in Thousands)

**9. Accounting for the Effects of Regulation (continued)**

The PUCT set forth the framework of the TNMIP rates, which provides for explicit recovery of all allowable development costs and all debt service costs over the financing period of the project. Some of the development costs encompassed in the rate order would otherwise be treated as period costs under generally accepted accounting principles. TNMIP rates were discontinued on January 2, 2013 after ERCOT achieved full recovery of the TNMIP recoverable costs. TNMIP development costs related to the systems under development were capitalized as discussed in Note 2. All other TNMIP development costs were subject to the provisions of regulatory accounting, which provides for deferral of the income statement impact.

The following is a reconciliation of TNMIP's long-term regulatory liability at December 31:

|  | <u>2015</u> | <u>2014</u>        |
|--|-------------|--------------------|
| TNMIP depreciation and expense not previously captured | \$ 33,526   | \$ 66,252          |
| Amortization of regulatory liability                   | 33,526      | 66,252             |
| Regulatory liability, beginning of year                | (33,526)    | (99,778)           |
| Regulatory liability, end of year                      | <u>\$ -</u> | <u>\$ (33,526)</u> |

This regulatory liability was fully amortized on June 30, 2015.

**10. Contingencies**

The Company is party to regulatory and legal proceedings that management considers to be normal actions to which an enterprise of its size and nature might be subject. Such proceedings are not anticipated to have a material impact on ERCOT's financial condition, results of operations, or cash flows.

**11. Subsequent Events**

ERCOT has evaluated material subsequent events through \_\_\_\_\_, 2016, the date the Company's financial statements were available to be issued.