Item 8.3: Review of Audited Financial Statements

Sean Taylor
Controller

Finance & Audit Committee Meeting

ERCOT Public
April 8, 2019

ercot

Your Power. Our Promise.

Financial Statements

Electric Reliability Council of Texas, Inc.

Years ended December 31, 2018 and 2017

With Report of Independent Auditors

April 2019

Electric Reliability Council of Texas, Inc.

Financial Statements

As of and for the Years Ended
December 31, 2018 and 2017

Contents

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the Electric Reliability Council of Texas, Inc. (“ERCOT”), which comprise the statements of financial position as of December 31, 2018 and 2017, and the related statements of activities and net assets and cash flows for the years 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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.

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, 2018 and 2017, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Austin, Texas
_____ __, 2019

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

	December 31 2018	December 31 2017
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 791,346	$ 501,001
Accounts receivable	5,871	4,757
Unbilled revenue	3,136	4,402
Restricted cash and cash equivalents	458,524	556,008
Short-term investments	99,943	-
Prepaid expenses and other current assets	27,792	26,365
Total current assets	1,386,612	1,092,533
Property and equipment, net	112,246	112,442
Systems under development	30,906	18,807
Total assets	$1,529,764	$1,223,782

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Financial Position (continued)

	December 31 2018	December 31 2017
	(In Thousands)	
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	$ 2,050	$ 5,330
Accrued liabilities	13,740	9,519
Deferred revenue	5,666	4,639
Market settlement liabilities	600,828	448,949
Security deposits	458,524	556,008
Notes payable, current portion	4,000	4,000
Total current liabilities	1,084,808	1,028,445
Notes payable, less current portion:		
Principal	51,000	55,000
Less unamortized debt issuance costs	186	197
Notes payable, less current portion and unamortized debt issuance costs	50,814	54,803
Long-term CRR liabilities	303,399	85,613
Other long-term liabilities	426	388
Total liabilities	1,439,447	1,169,249
Net assets without donor restrictions	90,317	54,533
Total liabilities and net assets	$1,529,764	$ 1,223,782

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets

	Year Ended December 31	
	2018	2017
	(In Thousands)	
Operating revenues:		
System administration fees	$ 209,881	$ 199,283
Reliability organization pass-through	16,328	14,345
Other services revenue	5,629	5,702
Total operating revenues	231,838	219,330
Operating expenses:		
Salaries and related benefits	106,356	103,820
Hardware and software maintenance and licensing	25,374	28,153
Outside services	15,236	12,715
Facility and equipment costs	8,992	9,664
Reliability organization assessment	16,328	14,345
Depreciation	28,321	27,148
Other	7,135	6,744
Total operating expenses	207,742	202,589
Income from operations	24,096	16,741
Other income (expense):		
Investment return, net	13,091	2,933
Interest expense	(1,438)	(1,884)
Non-operating income	35	5
Change in net assets without donor restrictions	35,784	17,795
Net assets without donor restrictions, beginning of year	54,533	36,738
Net assets without donor restrictions, end of year	$ 90,317	$ 54,533

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

	Year Ended December 31 2018	2017
	(In Thousands)	
Operating activities		
Change in net assets without donor restrictions	$ 35,784	$ 17,795
Adjustments to reconcile change in net assets without donor restrictions to net cash provided by operating activities:		
Depreciation	28,321	27,148
Amortization of debt issuance costs	15	19
Amortization of bond discount	(319)	-
Net losses (gains) on property and equipment	22	(3)
Changes in operating assets and liabilities:		
Accounts receivable	(1,114)	(357)
Unbilled revenue	1,266	(1,239)
Prepaid expenses and other current assets	(1,427)	(4,730)
Other long-term liabilities	38	13
Accounts payable	(1,873)	1,244
Accrued liabilities	1,895	(1,643)
Deferred revenue	1,027	436
Net cash provided by operating activities	63,635	38,683
Investing activities		
Purchase of Investments	(113,232)	-
Proceeds from Investments	13,608	-
Capital expenditures for property and equipment and systems under development	(39,342)	(32,466)
Proceeds from sale of property and equipment	15	3
Net cash used in investing activities	(138,951)	(32,463)

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

	Year Ended December 31 2018	2017
	(In Thousands)	
Financing activities		
Repayment of notes payable	(4,000)	(4,000)
Payment of debt issuance costs	(4)	(3)
Decrease (increase) in restricted cash	97,484	(168,823)
Increase in market settlement liabilities	151,878	192,809
Increase (decrease) in long-term CRR liabilities	217,787	(1,116)
(Decrease) increase in security deposits	(97,484)	168,823
Net cash provided by financing activities	365,661	187,690
Net increase in cash and cash equivalents	290,345	193,910
Cash and cash equivalents, beginning of year	501,001	307,091
Cash and cash equivalents, end of year	$ 791,346	$ 501,001
Supplemental information		
Cash paid for interest	$ 1,877	$ 1,959
Supplemental disclosures of non-cash investing and financing activities		
Change in accrued capital expenditures	$ 919	$ 1,048
Capitalized interest	$ 823	$ 434

See accompanying notes to the financial statements.

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 78,000 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.

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.

Net Assets Without Donor Restrictions

Net assets without donor restrictions are those that are not subject to donor 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 net assets without donor restrictions.

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.

2. Summary of Significant Accounting Policies (continued)

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).

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.

Custodial Credit Risk

ERCOT maintains cash balances at financial institutions, which, at times, may exceed Federal Deposit Insurance Corporation (FDIC) limits and are exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, ERCOT's deposits may not be returned. As of December 31, 2018 and 2017, $16,980 and $15,513 of the Company's bank deposits, respectively, was exposed to custodial credit risk.

2. Summary of Significant Accounting Policies (continued)

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. Revenue 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 statements of financial position. The SAF was 55.5 cents per megawatt hour of adjusted metered load in both 2018 and 2017. 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 that ERCOT offers or is required to provide its participants, including connectivity to ERCOT's grid, wide-area network usage, training for market participants, studies of operational issues, development of certain revisions to market rules and associated changes to IT systems, 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.

2. Summary of Significant Accounting Policies (continued)

Investments

Investments consist of US Treasury bonds, and are recorded at fair value in the statements of financial position. Net investment return is reported in the statements of activities and net assets, and consists of interest and unrealized capital gains and losses, less external investment expenses.

Investments are made by investment advisors whose performance is monitored by ERCOT's Investment Officers. Although the fair values of investments are subject to fluctuation on a year-to-year basis, we believe that the investment policies and guidelines are prudent for the long-term welfare of the Company.

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 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 statements of activities and net assets for the period. The Company recognized a (loss) gain of ($22) and $3 in 2018 and 2017, respectively, related to property and equipment. Repairs and maintenance costs are expensed when incurred.

2. Summary of Significant Accounting Policies (continued)

Property and Equipment (continued)

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

Asset Category	Depreciable Life
Computer hardware	3
Software	5
Vehicles	5
Furniture and equipment	7
Mechanical building components	10
Buildings and improvements	Up to 30
Leasehold improvements	Lesser of useful life 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. 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.

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.

2. Summary of Significant Accounting Policies (continued)

Impairment (continued)

An impairment loss of $37 was recognized in 2018, mainly due to software that did not perform to meet the Company's requirements. Impaired assets were then disposed in 2018. No impairments requiring write-offs were identified in 2017.

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 2018 and 2017, capitalized interest costs were $823 and $434, 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 obligations 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 before distribution to the market in accordance with timetables set forth in ERCOT's Protocols.

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.

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (continued)

Market Settlement Liabilities (continued)

Market settlement liabilities consist of the following at December 31:

	2018	2017
Short-term CRR auction funds	$ 498,320	$ 372,124
Prepayments of settlement obligations	102,508	76,825
Total current market settlement liabilities	600,828	448,949
Long-term CRR auction funds	303,399	85,613
Total market settlement liabilities	$ 904,227	$ 534,562

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 and cash equivalents on the Statements of Financial Position. The balance of cash security deposits is $458,524 and $556,008 at December 31, 2018 and 2017, respectively.

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 presented as a direct deduction from the debt liability, and amortized over the life of the debt.

Adoption of Accounting Standards Update (ASU)

The Financial Accounting Standards Board (FASB) issued ASU No. 2014-09 "Revenue from Contracts with Customers", with effective date January 1, 2019; ASU No. 2016-02 "Leases", with effective date January 1, 2020; ASU No. 2016-12 "Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients", with effective date January 1, 2019; ASU No. 2016-15 "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments", with effective date January 1, 2019; ASU No. 2016-18 "Statement of Cash Flows: Restricted Cash", with effective date January 1, 2019; ASU No. 2018-11 "Leases: Targeted Improvements", with effective date January 1, 2020; ASU No. 2018-13 "Fair Value Measurement: Disclosure Framework", with effective date January 1, 2020; and ASU No. 2018-15 "Intangibles - Goodwill and Other - Internal-Use Software", with effective date January 1, 2021. ERCOT has assessed the impacts and will adopt the amendments in these updates when they are effective.

2. Summary of Significant Accounting Policies (continued)

Adoption of Accounting Standards Update (ASU) (continued)

In August 2016, the FASB issued ASU No. 2016-14 “Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities”, with effective date January 1, 2018. ERCOT adopted ASU No. 2016-14, and has applied the changes retrospectively to all periods presented. The new standard changes the following aspects of the financial statements:

- The unrestricted net asset class has been renamed Net Assets Without Donor Restrictions

- The financial statements include a disclosure about liquidity and availability of resources (Note 4)

- Investment expenses are included in net investment income

- The financial statements include an analysis of expenses by both function and natural classification (Note 8)

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 statements of activities and net assets impact of certain revenues and charges because it is probable they will be recovered or repaid in future periods.

ERCOT does not have any regulatory assets or liabilities as of December 31, 2018 and 2017.

(Dollars in Thousands)

3. Reclassification of Prior Year Presentation

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications had no effect on the reported results of operations. Adjustments have been made to the statement of financial position at December 31, 2017, and the statement of cash flow for the year ended December 31, 2017, to identify long-term CRR liabilities from market settlement liabilities.

4. Liquidity and Availability

Financial assets available for general expenditures, that is, without donor or other restrictions limiting their use, within one year of the statement of financial position date, comprise the following:

	2018	2017
Cash and cash equivalents	$ 791,346	$ 501,001
Accounts receivable	5,871	4,757
Unbilled revenue	3,136	4,402
Short-term investments	99,943	-
Total	$ 900,296	$ 510,160

As part of ERCOT's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, ERCOT invests cash in excess of daily requirements in short-term investments and money market funds. To help manage unanticipated liquidity needs, ERCOT has committed a line of credit in the amount of $125,000 (see note 7), which it could draw upon.

5. 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.

(Dollars in Thousands)

5. Fair Value Measurement (continued)

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

	2018			
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents	$ 773,961	$ 773,961	$ -	$ -
Restricted cash equivalents	458,192	458,192	-	-
Investment				
US Treasury bonds	99,943	99,943	-	-
Total assets at fair value	$1,332,096	$1,332,096	$ -	$ -

	2017			
	Total	Level 1	Level 2	Level 3
Assets				
Cash equivalents	$ 500,110	$ 500,110	$ -	$ -
Restricted cash equivalents	540,827	540,827	-	-
Total assets at fair value	$1,040,937	$1,040,937	$ -	$ -

(Dollars in Thousands)

6. Property and Equipment

Property and equipment consist of the following at December 31:

	2018	2017
Depreciable:		
Software	$ 675,631	$ 665,933
Building and leasehold improvements	100,501	91,029
Computer hardware and equipment	79,713	81,877
Furniture and fixtures	37,169	35,785
Vehicles	130	123
Non-depreciable:		
Land	947	947
Construction in progress	44	893
	894,135	876,587
Accumulated depreciation	(781,889)	(764,145)
Total property and equipment, net	112,246	112,442
Systems under development	30,906	18,807
Total	$ 143,152	$ 131,249

7. Notes Payable

ERCOT's notes payable consist of the following:

	2018	2017
3.00% Senior notes	$ 55,000	$ 59,000

7. 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, and amended in December 2013, 2015, and 2017, respectively. 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, 2019. As of December 31, 2018 and 2017, 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 3.12% at December 31, 2018. Additionally, at December 31, 2018, 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 2018 and 2017, 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, 2018 and 2017, the revolving line of credit had unamortized debt issuance costs of $2 and $0, 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, 2018 and 2017, there were $55,000 and $59,000 outstanding senior notes, respectively and, $184 and $197 of unamortized debt issuance costs, respectively. ERCOT was in compliance with its covenants for these notes.

(Dollars in Thousands)

7. Notes Payable (continued)

Future Maturities

Future maturities of the senior notes are as follows:

	3.00% Senior Notes
Year Ending December 31:	
2019	$ 4,000
2020	4,000
2021	4,000
2022	4,000
2023	4,000
Thereafter through 2032	35,000
	$ 55,000

8. Expenses by Nature and Function

The financial statements report certain categories of expenses that are attributed to both program and supporting functions. Therefore, expenses require allocation on a reasonable basis that is consistently applied. Depreciation is allocated based on ratio of each function’s operating expenses to the total operating expenses. Interest expense is allocated based on project efforts. Other expenses are allocated based on the functions.

The tables below present expenses by both their nature and function for years ended December 31, 2018 and 2017, respectively.

(Dollars in Thousands)

8. Expenses by Nature and Function (continued)

	2018		
	Program Services	Management and General	Total
Salaries and related benefits	$ 97,687	$ 18,810	$ 116,497
Hardware and software maintenance and licensing	24,670	704	25,374
Outside services	12,877	2,359	15,236
Facility and equipment costs	4,031	4,961	8,992
Reliability organization assessment	-	16,328	16,328
Depreciation	23,067	5,254	28,321
Other	3,569	3,566	7,135
Subtotal expenses by function	165,901	51,982	217,883
Less capitalized labor expense included on the statement of financial position	(10,037)	(104)	(10,141)
Total operating expenses included on the statement of activities	$ 155,864	$ 51,878	$ 207,742
Interest expense	$ 823	$ 1,438	$ 2,261
Less capitalized interest expense included on the statement of financial position	(823)	-	(823)
Total interest expense included on the statement of activities	$ -	$ 1,438	$ 1,438
Total operating and interest expenses included on the statement of activities	$ 155,864	$ 53,316	$ 209,180

(Dollars in Thousands)

8. Expenses by Nature and Function (continued)

	2017		
	Program Services	Management and General	Total
Salaries and related benefits	$ 95,096	$ 18,258	$113,354
Hardware and software maintenance and licensing	27,649	504	28,153
Outside services	9,973	2,742	12,715
Facility and equipment costs	4,565	5,099	9,664
Reliability organization assessment	-	14,345	14,345
Depreciation	22,143	5,005	27,148
Other	3,488	3,256	6,744
Subtotal expenses by function	162,914	49,209	212,123
Less capitalized labor expense included on the statement of financial position	(9,373)	(161)	(9,534)
Total operating expenses included on the statement of activities	$ 153,541	$ 49,048	$202,589
Interest expense	$ 434	$ 1,884	$ 2,318
Less capitalized interest expense included on the statement of financial position	(434)	-	(434)
Total interest expense included on the statement of activities	$ -	$ 1,884	$ 1,884
Total operating and interest expenses included on the statement of activities	$ 153,541	$ 50,932	$204,473

(Dollars in Thousands)

9. 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 must be 21 years of age to be eligible to participate.

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:

	2018	2017
75% of the employee's contribution up to 6%	$ 3,341	$ 3,178
10% of the employee's compensation	8,444	8,002
Total employer contributions	$ 11,785	$ 11,180

Health Insurance Reserve

ERCOT provides a self-insured group health plan to its employees and pays for all health claims. Incurred-but-not-reported claims liability is accrued. At December 31, 2018 and 2017, the liability is $991 and $929, respectively.

(Dollars in Thousands)

10. Lease and Contract Commitments

The Company has non-cancelable operating leases and service contracts for telecommunication services, system infrastructure, and office facilities. ERCOT 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:

2019	$	546
2020		531
2021		456
2022		118
2023		12
Thereafter		134
Total minimum lease payments	$	1,797

ERCOT recognized $645 and $713 of office rent expense in 2018 and 2017, respectively.

11. 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.

11. Concentrations (continued)

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.

12. 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.

13. Subsequent Events

ERCOT has evaluated material subsequent events through April 10, 2019, the date the Company's financial statements were available to be issued.