



## **Item 5.3: Audited Financial Statements**

*Sean Taylor*

Vice President and Chief Financial Officer

Urgent Board of Directors Meeting

ERCOT Public

April 14, 2020



# Financial Statements

Electric Reliability Council of Texas, Inc.  
Years ended December 31, 2019 and 2018  
With Report of Independent Auditors

April 2020

Electric Reliability Council of Texas, Inc.

Financial Statements

As of and for the Years Ended  
December 31, 2019 and 2018

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## 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, 2019 and 2018, 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 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.

***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, 2019 and 2018, 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  
April 15, 2020

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

	December 31	
	2019	2018
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 973,050	\$ 791,346
Accounts receivable	5,856	5,871
Unbilled revenue	2,517	3,136
Restricted cash and cash equivalents	503,809	458,524
Short-term investments	102,097	99,943
Prepaid expenses and other current assets	29,595	27,792
Total current assets	<u>1,616,924</u>	<u>1,386,612</u>
Property and equipment, net	114,497	112,246
Systems under development	18,874	30,906
Total assets	<u>\$1,750,295</u>	<u>\$1,529,764</u>

See accompanying notes to the financial statements.



Electric Reliability Council of Texas, Inc.  
Statements of Financial Position (continued)

	December 31	
	2019	2018
	<i>(In Thousands)</i>	
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable	\$ 2,135	\$ 2,050
Accrued liabilities	11,170	13,740
Deferred revenue	5,693	5,666
Market settlement liabilities	691,914	600,828
Security deposits	503,809	458,524
Notes payable, current portion	4,000	4,000
Total current liabilities	1,218,721	1,084,808
Notes payable, less current portion:		
Principal	47,000	51,000
Less unamortized debt issuance costs	170	186
Notes payable, less current portion and unamortized debt issuance costs	46,830	50,814
Long-term CRR liabilities	359,345	303,399
Other long-term liabilities	359	426
Total liabilities	1,625,255	1,439,447
Net assets without donor restrictions	125,040	90,317
Total liabilities and net assets	\$1,750,295	\$1,529,764

*See accompanying notes to the financial statements.*

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
<b>Operating revenues:</b>		
System administration fees	\$ 213,959	\$ 209,881
Other services revenue	6,908	5,629
Total operating revenues	<u>220,867</u>	<u>215,510</u>
<b>Operating expenses:</b>		
Salaries and related benefits	115,124	106,356
Hardware and software maintenance and licensing	26,634	25,374
Outside services	17,029	15,236
Facility and equipment costs	9,527	8,992
Depreciation	29,016	28,321
Other	7,367	7,135
Total operating expenses	<u>204,697</u>	<u>191,414</u>
Income from operations	16,170	24,096
<b>Other income (expense):</b>		
Investment return, net	20,406	13,091
Interest expense	(1,744)	(1,438)
Non-operating (expense) income	(109)	35
Change in net assets without donor restrictions	<u>34,723</u>	<u>35,784</u>
Net assets without donor restrictions, beginning of year	90,317	54,533
Net assets without donor restrictions, end of year	<u>\$ 125,040</u>	<u>\$ 90,317</u>

See accompanying notes to the financial statements.



Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Change in net assets without donor restrictions	\$ 34,723	\$ 35,784
Adjustments to reconcile change in net assets without donor restrictions to net cash provided by operating activities:		
Depreciation	29,016	28,321
Amortization of debt issuance costs	16	15
Amortization of bond discount	(1,089)	(319)
Net losses on property, equipment and systems under development	481	22
Changes in operating assets and liabilities:		
Accounts receivable	15	(1,114)
Unbilled revenue	619	1,266
Prepaid expenses and other current assets	(1,803)	(1,427)
Other long-term liabilities	(67)	38
Accounts payable	33	(1,873)
Accrued liabilities	(139)	1,895
Deferred revenue	27	1,027
Security deposits	45,285	(97,484)
Market settlement liabilities	91,086	151,878
Long-term CRR liabilities	55,946	217,787
Net cash provided by operating activities	<u>254,149</u>	<u>335,816</u>
<b>Investing activities</b>		
Purchase of Investments	(210,502)	(113,232)
Proceeds from Investments	209,437	13,608
Capital expenditures for property and equipment and systems under development	(22,095)	(39,342)
Proceeds from sale of property and equipment	-	15
Net cash used in investing activities	<u>(23,160)</u>	<u>(138,951)</u>

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
<b>Financing activities</b>		
Repayment of notes payable	(4,000)	(4,000)
Payment of debt issuance costs	-	(4)
Net cash used in financing activities	(4,000)	(4,004)
Net increase in cash, cash equivalents, and restricted cash and cash equivalents	226,989	192,861
Cash, cash equivalents, and restricted cash and cash equivalents, beginning of year	1,249,870	1,057,009
Cash, cash equivalents, and restricted cash and cash equivalents, end of year	<u>\$1,476,859</u>	<u>\$1,249,870</u>
<b>Supplemental information</b>		
Cash paid for interest	<u>\$ 1,757</u>	<u>\$ 1,877</u>
<b>Supplemental disclosures of non-cash investing and financing activities</b>		
Change in accrued capital expenditures	<u>\$ (2,379)</u>	<u>\$ 919</u>
Capitalized interest	<u>\$ 399</u>	<u>\$ 823</u>

See accompanying notes to the financial statements.

# Electric Reliability Council of Texas, Inc.

## Notes to Financial Statements (Dollars in Thousands)

*As of and for the Years Ended  
December 31, 2019 and 2018*

### 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 82,000 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 directors representing two sub-segments of the consumer segment (commercial and industrial), five unaffiliated directors, and three ex-officio directors, that is, the Public Counsel as a third director representing the third sub-segment of the consumer segment (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)*

*As of and for the Years Ended  
December 31, 2019 and 2018*

**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.

Electric Reliability Council of Texas, Inc.  
Notes to Financial Statements (continued)  
*(Dollars in Thousands)*

*As of and for the Years Ended  
December 31, 2019 and 2018*

**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. ERCOT has not experienced, nor does it anticipate, any losses with respect to such cash deposits.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Revenue Recognition

Revenue is measured based on a consideration specified in a contract with a customer, and excludes amounts collected on behalf of third parties. ERCOT recognizes revenue when it satisfies a performance obligation by transferring control over a service to a customer.

A. Performance Obligations

*System administration services* - As the independent system operator for the region, ERCOT provides a variety of services to Texas electricity market participants. ERCOT schedules power on an electric grid that connects more than 46,500 miles of transmission lines and 650+ generation units, performs financial settlement for the competitive wholesale bulk-power market, and administers retail switching for 8 million premises in competitive choice areas. These services are performed to fulfill ERCOT's primary responsibilities which are maintaining system reliability, facilitating competitive wholesale and retail markets, and ensuring open access to transmission. ERCOT identifies a single performance obligation from these services which are considered a series of distinct services under the revenue standard. Revenue from system administration services, called the system administration fee (SAF) is recognized when services are performed over time. SAF is collected from electric service providers operating within the ERCOT region. 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. Services are billed each business day, and are generally due 2 business days after the invoice date. 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 2019 and 2018. It is structured to provide funding for ERCOT's core operations and related services.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Revenue Recognition (continued)

*Other services* - ERCOT offers or is required to provide its participants other services, including wide-area network usage (WAN) connectivity to ERCOT's grid, training for market participants, membership, and other miscellaneous services.

- 1) *WAN* - ERCOT provides, in accordance with its reasonable discretion and control, the design, engineering, procurement, and installation of the equipment and facilities necessary to interconnect market participant's data transfer system to ERCOT's data network and facilities for the sole purpose of transferring data between ERCOT and the market participant. Revenue is recognized when services are provided over time. Market participants are billed monthly based on actual cost incurred that are the responsibility of them, but were incurred by ERCOT. Payment term is net 30 days.
- 2) *Connectivity to ERCOT's grid* - Entities who propose new or updated generation resources to connect into the ERCOT grid are required to submit Generation Resource Interconnection or Change Request (GINR) to ERCOT. ERCOT coordinates studies on the request with relevant Transmission Service Providers and the entity. Study fees are paid together with the requests and are deferred in the Statements of Financial Position, and are recognized as revenue when studies are completed.
- 3) *Training for market participants* - ERCOT offers Operator Training and Black Start Training to market participants. Training fees are received during training registration and are recognized as revenue when trainings are completed.
- 4) *Membership* - Applicants pay annual membership dues to apply for ERCOT membership. Membership dues are deferred and revenue is recognized over the membership period.
- 5) *Other miscellaneous services* - ERCOT provides other miscellaneous services such as studies of operational issues, development of certain revisions to market rules and associated changes to IT systems. Revenue related to these services is recognized as the services are performed over time.



Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Revenue Recognition (continued)

*Reliability organization pass-through* – The North American Electric Reliability Corporation (NERC) invoices ERCOT for reliability functions performed by NERC and its delegated Texas Reliability Entity, Inc. In turn, ERCOT collects payment from market participants for this Electric Reliability Organization (ERO) billing. The ERO billing is based on actual NERC funding, and ERCOT collects this payment and remits it to NERC on a quarterly basis. ERO billing amount was \$18,947 and \$16,328 in 2019 and 2018, respectively. No revenue is recognized as there is no consideration to earn during this ERO billing pass-through (Note 2 Adoption of Accounting Standards Update).

B. Disaggregation of Revenue

The following table illustrates the disaggregation disclosure by service types and timing of revenue recognition.

<u>Service Types</u>	<u>Services transferred over time</u>	<u>Services transferred at a point in time</u>	<u>2019 Total</u>
System administration	\$ 213,959	\$ -	\$ 213,959
WAN	3,269	-	3,269
Connectivity to ERCOT's grid	-	2,596	2,596
Training for market participants	-	573	573
Membership	279	-	279
Other miscellaneous services	191	-	191
Total	<u>\$ 217,698</u>	<u>\$ 3,169</u>	<u>\$ 220,867</u>



Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Revenue Recognition (continued)

<u>Service Types</u>	<u>Services transferred over time</u>	<u>Services transferred at a point in time</u>	<u>2018 Total</u>
System administration	\$ 209,881	\$ -	\$ 209,881
WAN	2,909	-	2,909
Connectivity to ERCOT's grid	-	1,720	1,720
Training for market participants	-	443	443
Membership	284	-	284
Other miscellaneous services	273	-	273
Total	<u>\$ 213,347</u>	<u>\$ 2,163</u>	<u>\$ 215,510</u>

C. Contract Balances

The following table provides information about receivables, contracts assets, and contract liabilities from contracts with customers at December 31.

	<u>2019</u>	<u>2018</u>
Receivables	\$ 4,035	\$ 3,745
Contract assets	\$ 2,517	\$ 3,136
Contract liabilities	\$ 844	\$ 929

Balances of accounts receivable at December 31, 2019 and 2018 on the Statements of Financial Position also include \$1,700 and \$1,767 interest receivable, respectively and, \$121 and \$359 pass-through receivable, respectively, in addition to receivables from contracts with customers.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

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

**Accounts Receivable and Revenue Recognition (continued)**

Receivables are included in Accounts receivable on the Statements of Financial Position. Contract assets relate to the Company's rights to consideration for services provided but not billed at the reporting date for system administration. The contract assets are transferred to the receivables when invoices are billed. Contract liabilities relate to advance consideration received from customers for connectivity to ERCOT's grid and membership. Revenues are recognized when performance obligations are satisfied.

**D. Significant Judgements**

ERCOT recognizes revenues from system administration, WAN, membership and other miscellaneous services over time, as the Company determines that customers simultaneously receive and consume the benefits provided by ERCOT's performances. Revenue from system administration is recognized over time using output method which is based on actual load volume consumption. Revenues from WAN, and other miscellaneous services are recognized over time using cost based input method, which is based on actual incurred costs of the services provided by ERCOT. Revenue from membership is recognized over time on a straight-line basis, as ERCOT determines that customers benefit from membership services throughout the year, and the best measure of progress toward complete satisfaction of the performance obligation over time is a time-based straight-line measure.

ERCOT recognizes revenues from connectivity to ERCOT's grid studies and training from market participants at a point of time. ERCOT determines that customers receive the benefits from the services when ERCOT's performance obligations are satisfied, which are when the connectivity to ERCOT's grid study is completed, and training to market participants is provided.

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.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

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.

Prepaid Expenses and Other Current Assets

Prepaid expenses consist of amounts paid in advance for items that had not yet occurred as of the end of fiscal year. Prepaid expenses are amortized in the periods when items occur. Other current assets primarily include the non-vested portion of former employees' 401K accounts. The balances at December 31 are as following:

	2019	2018
Prepaid expenses	\$ 29,525	\$ 27,187
Other current assets	70	605
Total prepaid expenses and other current assets	<u>\$ 29,595</u>	<u>\$ 27,792</u>

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

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 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 of \$3 and \$22 in 2019 and 2018, 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 and improvements	Up to 30
Leasehold improvements	Lesser of useful life or respective lease term

Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
December 31, 2019 and 2018*

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

**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 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.

An impairment loss of \$478 and \$37 was recognized in 2019 and 2018, respectively, mainly due to software that did not perform to meet the Company's requirements. Impaired assets were then disposed.

**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 2019 and 2018, capitalized interest costs were \$399 and \$823, respectively.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

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.

Market settlement liabilities consist of the following at December 31:

	<u>2019</u>	<u>2018</u>
Short-term CRR auction funds	\$ 538,051	\$ 498,320
Prepayments of settlement obligations	153,863	102,508
Total current market settlement liabilities	<u>691,914</u>	<u>600,828</u>
Long-term CRR auction funds	359,345	303,399
Total market settlement liabilities	<u>\$ 1,051,259</u>	<u>\$ 904,227</u>

Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
December 31, 2019 and 2018*

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

**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 \$503,809 and \$458,524 at December 31, 2019 and 2018, respectively.

**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.

Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
December 31, 2019 and 2018*

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

**Adoption of Accounting Standards Update (ASU)**

The Financial Accounting Standards Board (FASB) issued ASU No. 2016-02 “Leases”, with effective date January 1, 2021; ASU No. 2018-11 “Leases: Targeted Improvements”, with effective date January 1, 2021; 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.

In May 2014, the FASB issued ASU No. 2014-09 “Revenue from Contracts with Customers (Topic 606)”, with effective date January 1, 2019. The new standard requires an entity to recognize revenue by applying the following steps: Identify the contract(s) with a customer; Identify the performance obligations in the contract; Determine the transaction price; Allocate the transaction price to the performance obligations in the contract; and Recognize revenue when (or as) the entity satisfies a performance obligation. It also requires sufficient information disclosure including performance obligations, disaggregated revenues, contract balances and significant judgments. ERCOT adopted ASU No. 2014-09, and has applied the changes retrospectively to all periods presented (Note 2 Accounts Receivable and Revenue Recognition).

In March 2016, the FASB issued ASU No. 2016-08 “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”, with effective date January 1, 2019. Under this update, reliability organization pass-through revenue which used to be reported at gross revenue needs to be reported at net revenue. ERCOT adopted ASU 2016-08 and has applied the changes retrospectively to all periods presented.



Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
December 31, 2019 and 2018*

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

**Adoption of Accounting Standards Update (ASU) (continued)**

In November 2016, the FASB issued ASU No. 2016-18 “Statement of Cash Flows: Restricted Cash”, with effective date January 1, 2019. The amendments in the update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the Statements of Cash Flows. ERCOT adopted it and has applied the changes retrospectively to all periods presented.

**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, 2019 and 2018.

**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 Statements of Cash Flow for the year ended December 31, 2018, to reclassify changes in settlement liabilities, long-term CRR liabilities and security deposits to changes in operating activities from changes in financing activities.

Electric Reliability Council of Texas, Inc.

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

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**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 Statements of Financial Position date, comprise the following:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 973,050	\$ 791,346
Accounts receivable	5,856	5,871
Unbilled revenue	2,517	3,136
Short-term investments	102,097	99,943
Total	<u>\$ 1,083,520</u>	<u>\$ 900,296</u>

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, which it could draw upon. The line of credit amount is \$125,000 through December 30, 2019, and \$100,000 starting December 31, 2019 (see note 7).

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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*As of and for the Years Ended  
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## 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.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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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:

	2019			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Cash equivalents	\$ 971,361	\$ 971,361	\$ -	\$ -
Restricted cash equivalents	503,485	503,485	-	-
Investment				
US Treasury bonds	102,097	102,097	-	-
Total assets at fair value	<u>\$1,576,943</u>	<u>\$1,576,943</u>	<u>\$ -</u>	<u>\$ -</u>

	2018			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
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	<u>\$1,332,096</u>	<u>\$1,332,096</u>	<u>\$ -</u>	<u>\$ -</u>

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
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6. Property and Equipment

Property and equipment consist of the following at December 31:

	2019	2018
<b>Depreciable:</b>		
Software	\$ 700,223	\$ 675,631
Building and leasehold improvements	101,287	100,501
Computer hardware and equipment	80,119	79,713
Furniture and fixtures	37,477	37,169
Vehicles	283	130
<b>Non-depreciable:</b>		
Land	947	947
Construction in progress	-	44
	<u>920,336</u>	<u>894,135</u>
Accumulated depreciation	(805,839)	(781,889)
Total property and equipment, net	<u>114,497</u>	<u>112,246</u>
Systems under development	18,874	30,906
Total	<u>\$ 133,371</u>	<u>\$ 143,152</u>

7. Notes Payable

ERCOT's notes payable consist of the following:

	2019	2018
3.00% Senior notes	<u>\$ 51,000</u>	<u>\$ 55,000</u>

Electric Reliability Council of Texas, Inc.

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

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**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 subsequent years when it expired. This facility is primarily used for short-term working capital needs, had a maximum amount of available credit of \$125,000 before the amendment in December 2019. After the amendment, the line of credit has a maximum amount of available credit of \$100,000 and expires on December 31, 2024. As of December 31, 2019 and 2018, 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 2.41% at December 31, 2019. Additionally, at December 31, 2019, ERCOT pays a commitment fee of 0.15% on the unused portion of the \$100,000 revolving credit facility. ERCOT incurred commitment fees totaling \$152 in both 2019 and 2018, 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, 2019 and 2018, the revolving line of credit had unamortized debt issuance costs of \$0 and \$2, 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, 2019 and 2018, there were \$51,000 and \$55,000 outstanding senior notes, respectively and, \$170 and \$184 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)

As of and for the Years Ended  
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7. Notes Payable (continued)

Future Maturities

Future maturities of the senior notes are as follows:

	<u>3.00%</u> <u>Senior Notes</u>
Year Ending December 31:	
2020	\$ 4,000
2021	4,000
2022	4,000
2023	4,000
2024	4,000
Thereafter through 2032	31,000
	<u>\$ 51,000</u>

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, 2019 and 2018, respectively.

Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
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8. Expenses by Nature and Function (continued)

	2019		
	Program Services	Management and General	Total
Salaries and related benefits	\$ 101,615	\$ 20,499	\$ 122,114
Hardware and software maintenance and licensing	25,307	1,327	26,634
Outside services	14,192	2,837	17,029
Facility and equipment costs	4,441	5,086	9,527
Depreciation	23,474	5,542	29,016
Other	3,702	3,666	7,368
Subtotal expenses by function	172,731	38,957	211,688
Less capitalized labor expense included on the statement of financial position	(7,054)	63	(6,991)
Total operating expenses included on the statement of activities	\$ 165,677	\$ 39,020	\$ 204,697
Interest expense	\$ 399	\$ 1,744	\$ 2,143
Less capitalized interest expense included on the statement of financial position	(399)	-	(399)
Total interest expense included on the statement of activities	\$ -	\$ 1,744	\$ 1,744
Total operating and interest expenses included on the statement of activities	\$ 165,677	\$ 40,764	\$ 206,441



Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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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
Depreciation	23,067	5,254	28,321
Other	3,569	3,566	7,135
Subtotal expenses by function	165,901	35,654	201,555
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	\$ 35,550	\$191,414
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	\$ 36,988	\$192,852

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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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:

	2019	2018
75% of the employee's contribution up to 6%	\$ 3,728	\$ 3,341
10% of the employee's compensation	8,791	8,444
Total employer contributions	<u>\$ 12,519</u>	<u>\$ 11,785</u>

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, 2019 and 2018, the liability is \$628 and \$991, respectively.

Electric Reliability Council of Texas, Inc.  
Notes to Financial Statements (continued)  
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## 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:

2020	\$	577
2021		475
2022		119
2023		12
2024		12
Thereafter		122
Total minimum lease payments	\$	<u>1,317</u>

ERCOT recognized \$695 and \$645 of office rent expense in 2019 and 2018, 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.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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**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 15, 2020, the date the Company's financial statements were available to be issued.