



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

*Sean Taylor*

Vice President and Chief Financial Officer

Urgent Finance & Audit Committee and Board of Directors Meeting

ERCOT Public

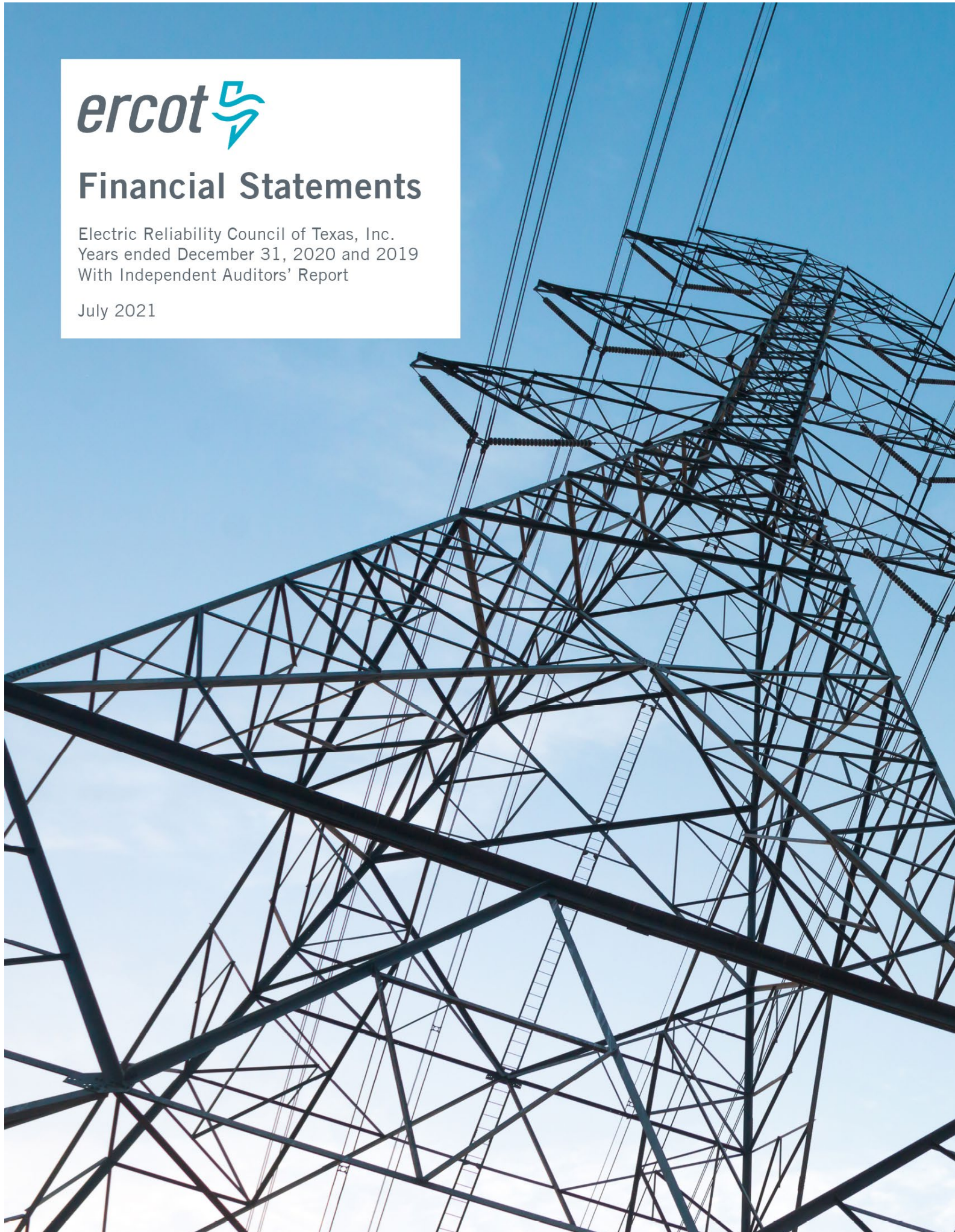
July 23, 2021



# Financial Statements

Electric Reliability Council of Texas, Inc.  
Years ended December 31, 2020 and 2019  
With Independent Auditors' Report

July 2021



Electric Reliability Council of Texas, Inc.

Financial Statements

As of and for the Years Ended  
December 31, 2020 and 2019

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## Independent Auditors' Report

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

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, 2020 and 2019, 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, 2020 and 2019, 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.

***Emphasis of Matter***

As discussed in Note 12 to the financial statements, ERCOT has been impacted by legislative, regulatory, legal and market participant responses resulting from Winter Storm Uri in February 2021. Our opinion is not modified with respect to this matter.

Minneapolis, Minnesota  
July 23, 2021

Electric Reliability Council of Texas, Inc.

Statements of Financial Position

	December 31	
	2020	2019
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 996,337	\$ 973,050
Accounts receivable	5,023	5,856
Unbilled revenue	2,607	2,517
Restricted cash and cash equivalents	658,559	503,809
Short-term investments	102,965	102,097
Prepaid expenses and other current assets	26,788	29,595
Total current assets	<u>1,792,279</u>	<u>1,616,924</u>
Property and equipment, net	109,356	114,497
Systems under development	27,522	18,874
Other long-term assets	1,042	-
Total assets	<u>\$1,930,199</u>	<u>\$1,750,295</u>

See accompanying notes to the financial statements.

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

	December 31	
	2020	2019
	<i>(In Thousands)</i>	
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable	\$ 3,472	\$ 2,135
Accrued liabilities	13,345	11,170
Deferred revenue	5,845	5,693
Market settlement liabilities	689,383	691,914
Security deposits	658,559	503,809
Notes payable, current portion	4,000	4,000
Total current liabilities	1,374,604	1,218,721
Notes payable, less current portion:		
Principal	43,000	47,000
Less unamortized debt issuance costs	173	170
Notes payable, less current portion and unamortized debt issuance costs	42,827	46,830
Long-term CRR liabilities	377,047	359,345
Other long-term liabilities	597	359
Total liabilities	1,795,075	1,625,255
Net assets without donor restrictions	135,124	125,040
Total liabilities and net assets	\$1,930,199	\$1,750,295

*See accompanying notes to the financial statements.*

Electric Reliability Council of Texas, Inc.

Statements of Activities and Net Assets

	Year Ended December 31	
	2020	2019
	<i>(In Thousands)</i>	
<b>Operating revenues:</b>		
System administration fees	\$ 212,185	\$ 213,959
Other services revenue	6,866	6,908
Total operating revenues	<u>219,051</u>	<u>220,867</u>
<b>Operating expenses:</b>		
Salaries and related benefits	119,099	115,124
Hardware and software maintenance and licensing	29,712	26,634
Outside services	16,586	17,029
Facility and equipment costs	9,472	9,527
Depreciation	30,142	29,016
Other	6,701	7,367
Total operating expenses	<u>211,712</u>	<u>204,697</u>
Income from operations	7,339	16,170
<b>Other income (expense):</b>		
Investment return, net	4,298	20,406
Interest expense	(1,576)	(1,744)
Non-operating income (expense)	23	(109)
Change in net assets without donor restrictions	<u>10,084</u>	<u>34,723</u>
Net assets without donor restrictions, beginning of year	<u>125,040</u>	<u>90,317</u>
Net assets without donor restrictions, end of year	<u><u>\$ 135,124</u></u>	<u><u>\$ 125,040</u></u>

See accompanying notes to the financial statements.



Electric Reliability Council of Texas, Inc.

Statements of Cash Flows

	Year Ended December 31	
	2020	2019
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Change in net assets without donor restrictions	\$ 10,084	\$ 34,723
Adjustments to reconcile change in net assets without donor restrictions to net cash provided by operating activities:		
Depreciation	30,142	29,016
Amortization of debt issuance costs	17	16
Amortization of bond discount	(100)	(1,089)
Net losses on property, equipment and systems under development	-	481
Changes in operating assets and liabilities:		
Accounts receivable	833	15
Unbilled revenue	(90)	619
Prepaid expenses and other current assets	2,807	(1,803)
Other long-term assets	(1,042)	-
Other long-term liabilities	238	(67)
Accounts payable	1,282	33
Accrued liabilities	2,083	(139)
Deferred revenue	152	27
Security deposits	154,750	45,285
Market settlement liabilities	(2,531)	91,086
Long-term CRR liabilities	17,702	55,946
Net cash provided by operating activities	216,327	254,149
<b>Investing activities</b>		
Purchase of Investments	(310,466)	(210,502)
Proceeds from Investments	309,698	209,437
Capital expenditures for property and equipment and systems under development	(33,502)	(22,095)
Net cash used in investing activities	(34,270)	(23,160)

See accompanying notes to the financial statements.

Electric Reliability Council of Texas, Inc.

Statements of Cash Flows (continued)

	Year Ended December 31	
	2020	2019
	<i>(In Thousands)</i>	
<b>Financing activities</b>		
Repayment of notes payable	(4,000)	(4,000)
Payment of debt issuance costs	(20)	-
Net cash used in financing activities	(4,020)	(4,000)
Net increase in cash, cash equivalents, and restricted cash and cash equivalents	178,037	226,989
Cash, cash equivalents, and restricted cash and cash equivalents, beginning of year	1,476,859	1,249,870
Cash, cash equivalents, and restricted cash and cash equivalents, end of year	<u>\$1,654,896</u>	<u>\$1,476,859</u>
<b>Supplemental information</b>		
Cash paid for interest	<u>\$ 1,638</u>	<u>\$ 1,757</u>
<b>Supplemental disclosures of non-cash investing and financing activities</b>		
Change in accrued capital expenditures	<u>\$ 147</u>	<u>\$ (2,379)</u>
Capitalized interest	<u>\$ 503</u>	<u>\$ 399</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, 2020 and 2019*

### 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 86,000 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, 2020 and 2019*

**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, 2020 and 2019*

**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, 2020 and 2019

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 710+ generation units, performs financial settlement for the competitive wholesale bulk-power market, and administers retail switching for nearly 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 2020 and 2019. 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, 2020 and 2019

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, 2020 and 2019

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 \$19,400 and \$18,947 in 2020 and 2019, respectively. No revenue is recognized as there is no consideration to earn during this ERO billing pass-through.

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>2020 Total</u>
System administration	\$ 212,185	\$ -	\$ 212,185
WAN	3,624	-	3,624
Connectivity to ERCOT's grid	-	2,770	2,770
Training for market participants	-	113	113
Membership	283	-	283
Other miscellaneous services	76	-	76
Total	<u>\$ 216,168</u>	<u>\$ 2,883</u>	<u>\$ 219,051</u>



Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2020 and 2019

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>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>

C. Contract Balances

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

	<u>2020</u>	<u>2019</u>
Receivables	\$ 3,164	\$ 4,035
Contract assets	\$ 2,607	\$ 2,517
Contract liabilities	<u>\$ 960</u>	<u>\$ 844</u>

Balances of accounts receivable at December 31, 2020 and 2019 on the Statements of Financial Position also include \$78 and \$1,700 interest receivable, respectively and, \$1,781 and \$121 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, 2020 and 2019*

**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, 2020 and 2019

2. Summary of Significant Accounting Policies (continued)

Investments

Investments consist of US Treasury bonds and bills, 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:

	2020	2019
Prepaid expenses	\$ 26,591	\$ 29,525
Other current assets	197	70
Total prepaid expenses and other current assets	<u>\$ 26,788</u>	<u>\$ 29,595</u>

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2020 and 2019

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 \$0 and \$3 in 2020 and 2019, 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, 2020 and 2019*

**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 \$0 and \$478 was recognized in 2020 and 2019, 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 2020 and 2019, capitalized interest costs were \$503 and \$399, respectively.

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2020 and 2019

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:

	2020	2019
Short-term CRR auction funds	\$ 640,338	\$ 538,051
Prepayments of settlement obligations	49,045	153,863
Total current market settlement liabilities	689,383	691,914
Long-term CRR auction funds	377,047	359,345
Total market settlement liabilities	<u>\$ 1,066,430</u>	<u>\$1,051,259</u>

Electric Reliability Council of Texas, Inc.

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

As of and for the Years Ended  
December 31, 2020 and 2019

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

**Market Settlement Liabilities (continued)**

ERCOT acts as the central counter-party for transactions in the ERCOT wholesale market between buyers and sellers, and ERCOT must maintain revenue neutrality in serving this market function. Because ERCOT acts only as the clearinghouse through which funds are exchanged between buyers and sellers in the ERCOT wholesale market, when an ERCOT market participant with a payment obligation “short pays” an invoice, the result is that ERCOT market participants that are due payments from those “short paid” invoices cannot be paid in full. ERCOT is a non-recourse entity for settlement of market participant “short payments” – meaning ERCOT does not take on the financial obligation. Per ERCOT Protocol Section 9.19.1(1), the "Default Uplift Invoice" process must be used by ERCOT to collect outstanding "short pay amounts for all Settlement Invoices in a month," in order to fully pay the ERCOT market participants that are due payments but have been “short paid.” By Protocol, ERCOT’s fees are paid from market receipts as a first priority before any market obligations are paid, and ERCOT bears no liability from market participant “short payments.”

**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 \$658,559 and \$503,809 at December 31, 2020 and 2019, respectively.

Electric Reliability Council of Texas, Inc.

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

*As of and for the Years Ended  
December 31, 2020 and 2019*

**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. 2018-15 “Intangibles - Goodwill and Other - Internal-Use Software”, with an effective date January 1, 2021. ERCOT is evaluating the impact of the adoption of this statement on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842)”. The guidance requires lessees to recognize assets and liabilities for most leases in their balance sheet. ERCOT adopted the amendments for its fiscal year beginning January 1, 2020, and used the optional transition method for all existing leases. The optional transition method enabled the adoption of the new standard as of the beginning of the period of adoption and did not require restatement of prior period financial information. As a result, prior period financial information was not recast and continues to be reported under the accounting guidance effective during those periods. At adoption, the Company elected the following practical expedients: (1) the “package of practical expedients”, pursuant to which the Company did not need to reassess prior conclusions regarding lease identification, lease classification and initial direct costs and (2) the creation of an accounting policy for short-term leases resulting in lease payments being recorded as an expense on a straight-line basis over the lease term. See Note 9 Leases.



Electric Reliability Council of Texas, Inc.  
Notes to Financial Statements (continued)  
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**2. Summary of Significant Accounting Policies (continued)**

**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, 2020 and 2019.

**3. 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:

	2020	2019
Cash and cash equivalents	\$ 996,337	\$ 973,050
Accounts receivable	5,023	5,856
Unbilled revenue	2,607	2,517
Short-term investments	102,965	102,097
Total	\$ 1,106,932	\$1,083,520

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 \$100,000 starting December 31, 2019 (see Note 6).

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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#### 4. 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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4. 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:

	2020			
	Total	Level 1	Level 2	Level 3
<b>Assets</b>				
Cash equivalents	\$ 990,811	\$ 990,811	\$ -	\$ -
Restricted cash equivalents	658,406	658,406	-	-
Investment				
US Treasury bonds & bills	102,965	102,965	-	-
Total assets at fair value	<u>\$1,752,182</u>	<u>\$1,752,182</u>	<u>\$ -</u>	<u>\$ -</u>

	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>

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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5. Property and Equipment

Property and equipment consist of the following at December 31:

	2020	2019
<b>Depreciable:</b>		
Software	\$ 718,900	\$ 700,223
Building and leasehold improvements	101,573	101,287
Computer hardware and equipment	83,937	80,119
Furniture and fixtures	37,986	37,477
Vehicles	283	283
<b>Non-depreciable:</b>		
Land	947	947
Construction in progress	294	-
	<u>943,920</u>	<u>920,336</u>
Accumulated depreciation	(834,564)	(805,839)
Total property and equipment, net	109,356	114,497
Systems under development	27,522	18,874
Total	<u>\$ 136,878</u>	<u>\$ 133,371</u>

6. Notes Payable

ERCOT's notes payable consist of the following:

	2020	2019
3.00% Senior notes	<u>\$ 47,000</u>	<u>\$ 51,000</u>

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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**6. 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, 2020 and 2019, 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 0.79% and 2.41% at December 31, 2020 and 2019, respectively. Additionally, at December 31, 2020, ERCOT pays a commitment fee of 0.15% on the unused portion of the \$100,000 revolving credit facility. ERCOT incurred commitment fees totaling \$153 and \$152 in 2020 and 2019, respectively, 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, 2020 and 2019, the revolving line of credit had unamortized debt issuance costs of \$16 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, 2020 and 2019, there were \$47,000 and \$51,000 outstanding senior notes, respectively and, \$157 and \$170 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)  
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**6. Notes Payable (continued)**

**Future Maturities**

Future maturities of the senior notes are as follows:

	<b>3.00% Senior Notes</b>
Year Ending December 31:	
2021	\$ 4,000
2022	4,000
2023	4,000
2024	4,000
2025	4,000
Thereafter through 2032	27,000
	\$ 47,000

**7. 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, 2020 and 2019, respectively.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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7. Expenses by Nature and Function (continued)

	2020		Total
	Program Services	Management and General	
Salaries and related benefits	\$ 107,843	\$ 21,842	\$ 129,685
Hardware and software maintenance and licensing	28,807	905	29,712
Outside services	14,012	2,574	16,586
Facility and equipment costs	4,793	4,679	9,472
Depreciation	24,569	5,573	30,142
Other	3,019	3,682	6,701
Subtotal expenses by function	183,043	39,255	222,298
Less capitalized labor expense included on the statement of financial position	(10,495)	(91)	(10,586)
Total operating expenses included on the statement of activities	\$ 172,548	\$ 39,164	\$ 211,712
Interest expense	\$ 503	\$ 1,576	\$ 2,079
Less capitalized interest expense included on the statement of financial position	(503)	-	(503)
Total interest expense included on the statement of activities	\$ -	\$ 1,576	\$ 1,576
Total operating and interest expenses included on the statement of activities	\$ 172,548	\$ 40,740	\$ 213,288

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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7. 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. 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:

	2020	2019
75% of the employee's contribution up to 6%	\$ 3,960	\$ 3,728
10% of the employee's compensation	9,544	8,791
Total employer contributions	<u>\$ 13,504</u>	<u>\$ 12,519</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, 2020 and 2019, the liability is \$701 and \$628, respectively.

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Notes to Financial Statements (continued)  
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**9. Leases**

ERCOT has non-cancelable operating leases for office facilities and office and telecommunication equipment. The terms of the Company's leases require monthly payments and expire in varying dates ranging from 2021 through 2035. All of the operating leases are fixed lease payments. The Company elected the practical expedient not to separate lease and non-lease components for the office facilities and office equipment leases. Most leases include options to renew, with renewal terms that can extend the lease term from 3 to 5 years. The exercise of lease renewal options is at the Company's sole discretion. The amounts of the right-of-use assets and lease liabilities are measured based on current expectations of not exercising the available renewal options. The existing leases are not subject to any restrictions or covenants which preclude the Company's ability to obtain financing or enter into additional leases.

As of December 31, 2020, the Company has an additional finance lease for a new Austin office facility of \$12,374. This lease will commence in year 2021 with a purchase option that the Company intends to exercise in year 2022.

Total lease costs including maintenance costs incurred during the years ending December 31, 2020 and 2019 were \$927 and \$936, respectively. The weighted average lease term for operating leases at December 31, 2020 was 3.9 years. Because the rate implicit in the lease was not readily determinable, ERCOT used a risk-free discount rate for the leases. The weighted average discount rate for operating leases at December 31, 2020 was 1.68%.

Cash paid for amounts in the measurement of lease liabilities included in the statement of cash flows as of December 31, 2020 was \$540.

Amounts recognized as right-of-use assets related to operating leases are included in other long-term assets; while related lease liabilities are included in accrued liabilities and other long-term liabilities. As of December 31, 2020, right-of-use assets and lease liabilities related to operating leases were as follows:

Electric Reliability Council of Texas, Inc.  
Notes to Financial Statements (continued)  
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9. Leases (continued)

	2020
<b>Operating leases:</b>	
Other long-term assets	\$ 1,042
Total operating lease right-of-use assets	\$ 1,042
Accrued liabilities	\$ 471
Other long-term liabilities	246
Total operating lease liabilities	\$ 717

The following table presents the future undiscounted maturities of operating leases at December 31, 2020 and for each of the next five years and thereafter:

2021	\$ 475
2022	119
2023	12
2024	12
2025	12
Thereafter	110
Total lease payments	740
Less imputed interest	(23)
Lease liabilities recognized	\$ 717

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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**10. 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.

**11. 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.

**12. Subsequent Events**

ERCOT has evaluated material subsequent events through July 26, 2021, the date the Company's financial statements were available to be issued.

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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**12. Subsequent Events (continued)**

On February 12, 2021, pursuant to Texas Government Code § 418.014, in response to an extreme winter weather event, Governor Greg Abbott issued a Declaration of a State of Disaster for all counties in Texas. Further, on February 15, 2021, ERCOT declared its highest state of emergency, an Energy Emergency Alert Level 3 (EEA3), due to exceptionally high electric demand exceeding limited supply.

As a result of the February 2021 extreme winter weather event, there remains approximately \$2,900,000 "short payments" by ERCOT market participants with payment obligations. The consequence of these "short payments" is that ERCOT market participants due payments from the above amounts have not been fully paid by ERCOT, and these entities will not be fully paid until the above "short payments" are collected in full. A small portion of the "short payment" amount is expected to be collected directly from the owing ERCOT market participants through payment plans. In addition, under order of the PUCT, ERCOT utilized approximately \$800,000 from the CRR auction funds to cover part of the "short payment" invoices that were due to ERCOT market participants on February 26, 2021. As stated in Note 2, ERCOT does not take on the financial obligation of wholesale market participant transactions, and as such, bears no liability for this amount.

Recent legislation, including Texas Senate Bill 1580 and Texas House Bill 4492, provided securitization financing mechanisms to recover extraordinary costs incurred due to the February 2021 extreme winter weather event.

Together, these two bills are expected to materially impact the balance that ERCOT expects to uplift to market participants. The precise financial impact of these two bills has not yet been determined. However, ERCOT expects that they may materially reduce the aggregate amount of uplift, as well as change the time period over which uplift charges may be assessed (capped at 30 years under HB 4492).

Electric Reliability Council of Texas, Inc.

Notes to Financial Statements (continued)  
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**12. Subsequent Events (continued)**

Also, as a result of February 2021 extreme winter weather event, ERCOT is a party to multiple legal proceedings. Specifically, ERCOT is a defendant in dozens of wrongful death and property damage lawsuits, which are being consolidated for adjudication in a multi-district litigation pre-trial court. In addition, ERCOT is currently a defendant in two lawsuits challenging energy pricing during the February 2021 extreme winter weather event. ERCOT does not believe that these proceedings are anticipated to have a material impact on ERCOT's financial condition, results of operations, or cash flows.

On June 8, 2021, Texas Governor Greg Abbott signed Senate Bill 2. Senate Bill 2 will change the required composition of the ERCOT Board. Once fully implemented, the ERCOT Board will be composed of 11 Board Directors (9 voting and two non-voting) and eliminate Market Segment representation.