



## **Item 10: Results of Examination and Independent Report from the Service Auditor**

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Board of Directors Meeting

ERCOT Public

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# Discussion Topics

1. ERCOT Examination Overview
2. Audit Approach
3. Auditor Independence



# SOC 1 Examination Overview

## Overview

- SOC 1 Examinations, under the Statement on Standards for Attestation Engagements (SSAE) No. 18, are utilized to report on controls at service organizations that are relevant to user entities' internal control over financial reporting.
- The 2021 SOC 1 examination examined ERCOT Settlement Operations and the supporting IT applications and systems for the period October 1, 2020, to September 30, 2021.
- 19 Control Objectives were within the scope of the 2021 examination.
- Testing was conducted in two phases: (Q2) April-May 2021 and (Q3) September 2021



# SOC 1 Examination Overview

## Results

- The 2021 SOC 1 Examination Report for Settlement Operations is ready for issuance pending Board approval.
- The report will be issued with an unmodified opinion.
- Section 1 – An informational paragraph (Emphasis-of-Matter) was included in the Service Auditor's Report.
- Section 4 - One testing exception and two informational disclosures were reported during the 2021 examination.



# SOC 1 Examination Overview

## Emphasis of Matter

ERCOT's description of its Settlement Operations system states that control activities are designed and operating to provide reasonable assurance that only qualified Market Participants can participate in the ERCOT market. However, during the period October 1, 2020, through September 30, 2021, due to the winter storm that impacted the state of Texas in February 2021, and at the direction of the Public Utility Commission (PUC) of Texas, ERCOT took the following actions relevant to the aforementioned statement in the description, as applicable:

- Deviated from protocol deadlines and timing related to settlements, collateral obligations, and invoice payments
- Utilized available undistributed funds to cover short-paying invoice recipients
- Relaxed credit requirements and releasing cash or other collateral to provide short-term market participant liquidity
- Deviated from protocol requirements regarding the maximum amount of default uplift invoices
- Suspended breach notification to certain market participants for failure to make payment or provide financial security
- Produced reconciliation settlements following market stabilization

As a result of PUC-initiated deviations from protocol, certain market participants who were in breach according to the standard protocols were allowed to continue to participate in the ERCOT market. As such, the service auditor's test results were evaluated in consideration of the modified protocols described above.



# SOC 1 Examination Overview

## Control Deviations and Disclosures

#	Review Area	Control Activity Specified by the Service Organization	Test Applied by the Service Auditor	Test Result
1	QSE Qualification and Credit Monitoring	1.2.3 - The credit department receives payment information from the treasury department and evaluates whether there are any late or outstanding payments. Additional financial assurances are requested and collected in cases of repeated late payments.	Inspected the late payment notification for a sample of late payments recorded during the period to determine that the credit department reviewed each late or outstanding payment sampled and additional financial assurances were requested and collected in cases of repeated late payments.	The test of the control activity disclosed that late invoices identified during the period that were impacted by the winter storm were handled according to modified protocols as directed by the Public Utility Commission of Texas, project 51812, item 7.  No exceptions were noted related to the credit department's receipt and evaluation of late or outstanding invoices.
		1.2.4 - Financial assurances are applied to outstanding invoices, if necessary, to remedy a short payment resulting from a QSE default.	Inspected the late payment notification, the collateral request notification, and collateral application validation for a sample of late payments recorded during the period to determine that financial assurances were applied to outstanding invoices, if necessary, to remedy a short payment resulting from a QSE default.	The test of the control activity disclosed that short payments related to QSE defaults identified during the period that were impacted by the winter storm, were handled according to modified protocols as directed by the Public Utility Commission of Texas, project 51812, item 7.
2	LMP Price Validation	5.1.4 - By 16:00 of the second business day after the operating day, the market validation team completes an initial analysis on RTM pricing for the operating day prior to real time LMPs and SPPs being deemed final. An internal PVT report will be generated and documented for reference purpose. By close of business on the second business day following each operating day, a report or a delay notice will be released if there is major price issue or price correction that has been identified.	Inspected the SCED PVT reports for a sample of dates during the period to determine that by 16:00 of the second business day after the operating day, the market validation team completed an initial analysis on RTM pricing for the operating day prior to communicating finalization of real time LMPs and SPPs for each date sampled.	The test of the control activity, performed in May 2021, disclosed that a market notice was not released by close of business on the second business day following the operating day for one of 10 dates requiring price correction. Subsequent testing of the control activity, performed in September 2021, disclosed that a market notice was released by close of business on the second business day following the operating day for four of four dates requiring price correction.



# Audit Approach

## Audit Team

- The audit team for the ERCOT SOC 1 Engagement consists of a primary and secondary principal, senior manager, audit manager, and experienced senior auditors.
- The SOC 1 Examination Report is subjected to a quality assurance process, and is reviewed by the senior auditor, audit manager, senior manager, and two principals prior to release to ERCOT for review and approval. Two additional reviews are performed by operations personnel during final report preparation procedures.

## Sampling

- Testing is performed in two phases (Q2 and Q3) and the sampling methodology covers the full 12-month review period
- Our sampling approach is based on the AICPA's AU-C Section 530



# Audit Approach

## Additional and Modified Testing Procedures

Due to the winter storm event that occurred during the period under review for this examination, Schellman enacted additional and modified testing procedures in order to sufficiently capture the results of operational effectiveness for the in-scope controls. The following is a summary of those modified and additional testing procedures included in our assessment for the current period:

- Additional inquiry testing was performed for all areas of the control framework, specifically focused on the impact of the winter storm on operations within each area of operation.
- Based on the results of the additional inquiry testing, where appropriate, additional or modified observation and inspection testing was performed to supplement the standard testing.
- For controls that are designed to operate on a daily or weekly basis, Schellman expanded the sample size to include the days and weeks that were most impacted by the winter storm. This included the week of February 15, 2021, as well as each weekday during the week of February 15, 2021.
- The results of those testing procedures in control areas affected by the PUC directive for temporary modification or suspension of standard operating protocols were analyzed according to the specified modification or suspension during the time period covered by the directive.

The modifications to our standard testing procedures were limited to the period of time covered by the PUC directive. No additional modifications were made to our standard testing approach.



# Auditor Independence

- Professional standards require that CPA firms maintain independence in fact and appearance from their clients.
- To meet this requirement, we have implemented the following policies and procedures:
  - Implementation of Quality Control Procedures
  - Education on Independence
  - Elimination of all consulting services
  - Prohibition of any direct or materially indirect financial interest in clients by employees or their close relatives
  - Annual independence verification



# Our Remote Audit Approach

## In Response to the COVID-19 Pandemic

- In the midst of the COVID-19 pandemic, our first priority is the health and safety of our teams and our clients. However, our commitment to deliver quality and consistent services is unchanged, whether they be performed onsite or remotely, should they occur under normal conditions or during these challenging times.
- Our audit approach for the 2021 Type 2 SOC 1 examination was modified in order to accommodate both the needs of ERCOT and the travel restrictions put in place by Schellman & Company in response to the COVID-19 pandemic.
- Despite the modifications to the execution of the examination, all procedures were performed in accordance with SOC 1 examination and AICPA audit standards and guidelines.



# Our Remote Audit Approach

## Modifications to Examination Execution

- In lieu of in-person, onsite meetings with subject matter experts and control owners, meetings were held using commercial meeting software, both video and audio, in order to conduct interviews.
- A request and document management system was used in order to manage evidence requests and artifacts. This system, AuditSource, was developed and is solely owned by Schellman. AuditSource was used in prior examinations.
- Remote video walk throughs of the in-scope facilities were performed for the purposes of completing observation testing of the physical and environmental controls of the secure facilities. This video observation was in addition to inspection testing of relevant artifacts.

