



Internal Audit Department Charter

To ensure independence of the Internal Audit function, the Board of Directors (Board) has delegated oversight of the Internal Audit Department to the Finance and Audit Committee (Committee).

MANDATE

The Committee grants the Internal Audit function the mandate to perform assurance and advisory engagements providing objective advice, insight and foresight to the Committee and senior management.

Authority

The Committee authorizes the Internal Audit function to:

- Be granted unlimited access to all activities, employees, property, and records related to audit activities. Though such access shall be unlimited, the internal auditors shall ensure the safekeeping and confidentiality of all records and information in their possession.
- Allocate resources, set frequencies, select subjects, determine scopes of work, apply techniques and issue communications to accomplish the function's objectives.
- Have full and free access to the Committee and the authority to conduct audits independently and without interference to accomplish audit objectives.

Organizational Reporting and Independence

The Internal Audit function's authority is created by its direct reporting to the Committee, allowing unrestricted access to the Board. The Chief Audit Executive (CAE) reports functionally to the Committee and administratively to the Senior Vice President, Regulatory Policy, General Counsel, Chief Compliance Officer, and Corporate Secretary (GC).

The CAE will annually assess whether the responsibility, authority, and organizational independence, as defined in this Internal Audit Department Charter, continue to be adequate to enable the Internal Audit Department to accomplish its objectives. The result of this annual assessment will be communicated to executive management and the Committee. Any interference or lack of cooperation internal auditors encounter related to the scope, performance, or communication of internal audit work and results will be disclosed to the Committee, including the implications of such interference on the internal audit function's effectiveness and ability to fulfill its mandate.

PURPOSE, MISSION, AND SCOPE

Internal auditing strengthens the organization's ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective assurance, advice, insight, and foresight.

The mission of Internal Audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve the organization's operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

The Internal Audit Department is an independent function established within Electric Reliability Council of Texas, Inc. (ERCOT) to plan, develop and perform internal auditing activities. In support of ERCOT's strategic objectives, the Internal Audit Department provides management with recommendations for improving operations through assurance and consulting services. Assurance services are an independent and objective examination of evidence to ensure risk management, control, and governance processes are adequate and functioning in an appropriate manner. Consulting services are advisory in nature and may include facilitation, training, and advisory services. The audit plan may include assurance activities, consulting engagements and special projects requested by the Committee, the Board or executive management.

PROFESSIONAL STANDARDS AND PROCEDURES

Internal Audit Department activities are conducted in accordance with the mandatory guidance of *the Global Internal Audit Standards (Standards)*, promulgated by the Institute of Internal Auditors. In addition, the Internal Audit Department will adhere to ERCOT's policies and procedures and Internal Audit's Department Guide.

The Internal Audit Department will be subject to the required external quality assurance review every five years in accordance with professional standards. Additionally, an internal continuous monitoring assessment program provides assurance of adherence to auditing standards, staff training requirements and job performance expectations. The CAE must communicate the results of the quality assurance and improvement program to executive management and the Committee.

OBJECTIVITY

The Internal Audit Department has no direct authority over the activities under review. Internal auditors should not be assigned duties or engage in any activities they would normally be expected to review since performance of these operational duties might compromise their objectivity. Examples include implementing internal controls, developing procedures, installing systems, preparing records, directing employees not employed by the Internal Audit Department, or engaging in any other activity that would normally be audited. Objectivity is essential to properly fulfilling internal audit responsibilities.

ACCOUNTABILITY

The Director of Internal Audit is the CAE at ERCOT. The CAE, in the discharge of his/her duties, shall be accountable to the GC and the Committee as delegated by the Board to:

- Periodically provide information on the status and results of audit work, the annual audit plan, and the sufficiency of Internal Audit Department resources,
- Coordinate with executive management in the development of an annual risk assessment, and audit plan that effectively addresses issues of control, risk management, and governance processes.

The CAE serves at the pleasure of the Committee. The CAE will confer with the GC in advance of meeting with the Committee unless the CAE believes the GC's involvement in any matter may interfere with the CAE's unbiased and objective assessment.

KEY ROLES AND RESPONSIBILITIES

Key roles and responsibilities of the CAE, Committee, GC and executive management are critical to the success of the internal audit function. The CAE will assist the GC and executive management in the identification and management of company risks.

Key responsibilities of the CAE include:

- Developing an effective internal auditing program based on a flexible, risk-based annual audit plan, and submitting the plan to the Committee for review and approval.
- Implementing the approved annual audit plan including all assurance and consulting projects.
- Effectively communicating the results of audit projects.
- Providing periodic status reports of the audit plan and results to the CEO, GC and the Committee.
- Working with the GC and Committee to assess the budget and staffing levels of the Internal Audit Department.
- Maintaining a professional audit staff with sufficient knowledge, skills, experience, and professional certifications.
- Establishing a quality assurance program by which the CAE assures efficient and effective performance of internal auditing activities; and
- Conducting investigations at the direction of the Committee Chairman and the Committee.

Key responsibilities of the Committee include:

- Approving the Internal Audit Department Charter annually.
- Providing any input and approving the risk-based annual internal audit plan.
- Approving the Internal Audit Department budget and resource plan.
- Approving the selection of the external quality assurance reviewer every five years.
- Reviewing internal audit reports.
- Receiving communications from the CAE on the Internal Audit Department's performance relative to its plan and other matters.
- Approving decisions regarding the appointment and removal of the CAE.
- Consulting with the GC regarding the remuneration of the CAE; and
- Inquiring of management and the CAE to determine whether there are inappropriate scope or resource limitations.

Key responsibilities for the GC include:

- Initiating the recruitment and hiring of a qualified CAE/Internal Audit Director.

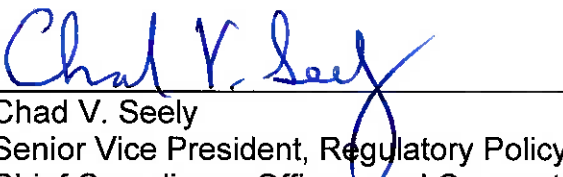
- Ensuring the independence of the internal audit function through establishment of an organizational structure with direct lines of reporting between the CAE and the GC.
- Assessing the Internal Audit Department's budget and staffing levels in coordination with the CAE for Committee approval.
- Performing an annual evaluation of the CAE.
- Reviewing and accepting internal audit reports.
- Contributing to and reviewing the results of the risk assessment prepared to support the annual internal audit plan.
- Reviewing the Internal Audit Department Charter; and
- Communicating with the CAE regarding issues or concerns pertaining to internal audit activities.

Key responsibilities for executive management include:

- Cooperating with audit teams during the performance of internal audits by granting unlimited access to all activities, employees, property, and records requested by the auditors.
- Reviewing internal audit reports and providing written responses to address issues and recommendations, and ensuring corrective actions are taken or accepting the associated risk; and
- Providing information to auditors regarding the occurrence and status of significant issues, which pertain to the organization and its risks.



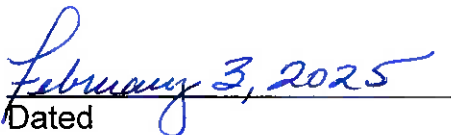
Penny V. Rychetsky
Chief Audit Executive



Chad V. Seely
Senior Vice President, Regulatory Policy, General Counsel
Chief Compliance Officers and Corporate Secretary



Bill Flores
Finance and Audit Committee Chairman



Dated