ERCOT
Finance & Audit Committee Meeting
Austin Airport Hilton Hotel, 9515 New Airport Drive, Austin, TX 78719
December 12 , 2006; 9:00-11:00 a.m.**

Agenda Item #	Description/Purpose/Action Required	Presenter	Time
	Call to Order	C Karnei	9:00 a.m.
1.	Adjourn to Executive Session		9:00 a.m.
	• Significant Audit Findings	B Wullenjohn	9:00 a.m.
	• EthicsPoint Update	C Vance	9:05 a.m.
	• Timing for Quality Assurance Review of the Internal Audit Department	B Wullenjohn	9:10 a.m.
	• Staffing Update and Assessment of the Adequacy and Effectiveness of the Internal Audit Staff	C Karnei	9:15 a.m.
	• Discussion with Executive Management	Jones/ Byone	9:30 a.m.
	Reconvene to General Session		9:40 a.m.
2.	Approval of Minutes* (Vote) (10/17/06)	C Karnei	9:40 a.m.
3.	Review PwC Non Audit Fees – Accounting Database Subscription (memo)	M Petterson	9:45 a.m.
4.	Materiality Principles (memo)	M Petterson	9:50 a.m.
5.	Review Proposed Agenda for Credit Workshop	C Yager	9:55 a.m.
6.	Accounting Highlights – Nodal & IMM	M Petterson	10:00 a.m.
7.	Review SAS 70 Action Plan	J Brenton/ A Delenela	10:15 a.m.
8.	Review F&A Self Assessment Results	C Karnei	10:25 a.m.
9.	Review Preliminary 2007 F&A Meeting Planner	S Byone	10:40 a.m.
10.	Committee Briefs		10:45 a.m.
	• ERM		
	• PMO		
	• Credit		
	• ICMP		
11.	Future Agenda Items	S Byone	10:55 a.m.
	Adjourn		11:00 a.m.

*** Background material enclosed or will be distributed prior to meeting. All times shown in the Agenda are approximate*
The next FA Committee Meeting will be held in January 2007; date to be determined at the December 2006 Board Meeting

Draft MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING
Austin Met Center
7:30 A.M.
November 14, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:30 A.M. on **November 14, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Present
Miguel Espinosa, Vice Chair	Independent Board Member	Independent Board Member	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Not Present
William Taylor	Calpine Corporation	Ind. Generator	Present

ERCOT staff and guests present:

Barry, Sean	PriceWaterhouseCoopers (PwC)
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Davies, Morgan	Calpine
Doolin, Estrellita	ERCOT
Gresham, Kevin	Reliant Energy
Hancock, Misti	ERCOT
Jones, Sam	ERCOT (CEO)
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Mueller, Paula	PUCT
Petterson, Mike	ERCOT
Greer, Clayton	Constellation
Ruebsahm, Jamille	Deloitte & Touche (D&T)
Saathoff, Kent	ERCOT
Schwerdtfeger, Kathie	Deloitte & Touche (D&T) via telephone
Troxtell, David	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Walker, Mark	NRG
West, James	PriceWaterhouseCoopers (PwC)
Wullenjohn, William	ERCOT
Yager, Cheryl	ERCOT

Executive Session
At 7:30 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 8:11 AM. The Committee returned to Open Session at 8:17 AM.

Commendation
Mike Espinosa moved to commend Bob Manning for his dedicated service on the Finance & Audit Committee; William Taylor seconded the motion. The motion passed unanimously.

Approval of Previous Minutes
Bob Manning moved to approve the minutes for the previous meetings held on October 17, 2006, with one amendment as attached hereto; **William Taylor seconded the motion. The motion passed unanimously.**

Approval of 2007 Audit Plan

Miguel Espinosa moved to approve the 2007 Internal Audit Plan, as presented in Executive Session; **Bob Manning seconded the motion. The motion passed unanimously.**

Contract / Conflicts Issue

Cheryl Yager explained that, over the past year or two, a large number of financial institution affiliates have become ERCOT market participants, both as Qualified Scheduling Entities and as Transmission Congestion Rights (TCR) holders. Ms. Yager noted that, as the number of financial institutions with market participant affiliates has increased, the group of qualified financial institutions that are not related to a market participant and from which ERCOT can obtain debt financing has dramatically decreased, causing concern about ERCOT's ability to obtain needed debt financing on a competitive basis. In addition, the number of financial institutions with which ERCOT can temporarily invest excess funds and which it can use for other administrative services has decreased, although this is not as problematic.

The Committee stated that it deemed it desirable to permit ERCOT to use financial institutions that are affiliates of market participants for ERCOT financing, banking, and other administrative services (for example, benefits administration and transfer agent services) and ERCOT and market participant fund investments, so long as the market participant and its financial institution affiliate agree to acceptable confidentiality provisions, in order to provide ERCOT with competitive options

William Taylor moved to recommend to the Board that ERCOT be permitted to use financial institutions that are affiliates of market participants for ERCOT debt financing, banking, other administrative services, and investments, so long as the financial institution and the market participant execute an acceptable confidentiality agreement with ERCOT; **Scott Gahn seconded the motion. The motion passed unanimously.**

2007 Strategic Financial Plan and Budget

Steve Byone provided an overview of ERCOT's 2007 Strategic Financial Plan and Budget and explained that he was seeking the Committee's recommendation for approval. Mr. Byone

reviewed the Budget, explaining that the system administrative fee would remain stable at 41.71 cents per MWh, not including the Nodal Surcharge or the new Electric Reliability Organization ("ERO") fee that had been approved by FERC, and answered questions from the Committee. Mr. Byone informed the Committee that the 2007 ERO fee was estimated to be approximately 1.5 to 2.1 cents per MWh. Mr. Byone answered the Committee's questions regarding the proposed $37 million for Zonal projects that were being managed as a component of the Texas Nodal Market Implementation Program ("TNMIP"), and outlined the two alternatives that staff proposed regarding the funding of the $37 million. The Committee discussed the 2007 Strategic Financial Plan and Budget and the pros and cons of each of the funding alternatives in detail. Mr. Byone confirmed to the Committee that the PUCT had indicated its acceptance of the Budget and either of the alternatives. In response to the Committee's concern regarding the modification to the debt to equity ratio cap, Mr. Byone informed the Committee that the PUCT had indicated that, if the first Alternative (proposing a temporary increase in debt funding of projects from 60 percent to near 73 percent) was selected, the PUCT would consider issuing an order that the 60/40 debt to equity ratio be restored by the end of 2008.

After extensive discussion, William Taylor moved to recommend to the Board that the proposed 2007 Strategic Plan and Budget, with Alternative #1, be approved; Bob Manning seconded the motion. The motion passed unanimously.

Third Party Audits

A. Deloitte & Touche ("D&T) Agreed Upon Procedures Internal Controls Assessment

Kathie Schwerdtfeger of D&T provided an update of the Agreed Upon Procedures Internal Controls Assessment. After a brief review of D&T's history with ERCOT's internal controls, Ms. Schwerdtfeger informed the Committee that D&T had concluded its fieldwork and that the final report would be completed soon. She noted that the key controls were adequately designed and documented for all areas reviewed and the ICMP program design was 100% appropriate. Ms. Schwerdtfeger noted that the report would identify some opportunities for key controls to operate more effectively. She reported that out of 152 controls tested, 145 were found to be operating effectively, which provided a pass rate of greater than 95%. When Mr. Karnei asked for examples of areas that were not operating effectively, Jamille Ruebsahm explained that the primary issues were caused by lack of proper documentation to evidence compliance. Mr. Karnei asked if remediation had begun on all areas with issues, and Mr. Byone responded that remediation was absolutely underway, which Ms. Schwerdfeger confirmed. Ms. Schwerdtfeger commended ERCOT on the significant progress to date and encouraged continued focus and support of the ICMP to ensure the sustainability and operating effectiveness of the newly designed control environment. Mr. Karnei requested that D&T make a presentation of the results to the full Board in January.

B. 2006 SAS 70 Audit

Sean Barry of PricewaterhouseCoopers ("PwC") confirmed that the 2006 SAS 70 audit was on schedule and that no exceptions had been noted in 17 of 18 of the Control Areas. Mr. Barry noted that this was a significant achievement for ERCOT because for 95% of the areas tested, there were not only no qualifications but also no exceptions, including the Physical Security area, which had significant exceptions in 2005. Mr. Barry also noted that it was significant that mid-period changes in Information Technology staff (departure of the director and several managers) were handled with sustained effective controls and no exceptions.

Mr. Barry informed the Committee that the only area that he believed would be qualified in the audit report was the Logical Security area, which included a number of exceptions. Most of the Logical Security findings were in the same areas as 2005, including the recertification process, certain terminations of access that did not occur for all systems, and policies that were written differently than the actual activities being carried out by the company. Jim Brenton noted that the areas with deficiencies were the same areas that had been identified by Security as having issues, and that these areas were being addressed. Mr. Barry noted that there had been improvements from 2005 and that Logical Security was the area in which most ISOs traditionally experienced difficulty. William Taylor asked whether all processes were correct and only documentation was lacking, and Mr. Barry noted that this was primarily the case, but that one area did need better procedures, which were being remedied by Mr. Brenton's team.

Mr. Barry told the Committee that PwC had reviewed the findings with management and management had developed an action plan to correct the problems. Mr. Brenton confirmed that action teams had already been formed and were in the process of addressing all issues. Mr. Brenton informed the Committee that he believed that all Logical Security issues would be resolved by January. Mr. Espinosa requested that Mr. Brenton provide a report by January on the progress of the remediation plans. Mr. Karnei requested that this update be put on the December or January Committee agenda.

C. 2006 Financial Audit

James West and Mr. Barry reviewed the audit plan for the 2006 financial audit for the Committee, noting that the plan, which would begin in earnest in January 2007 and complete in April 2007, was similar to the 2005 audit plan. Mr. Karnei confirmed that PwC would review the capitalizable life of software and hardware, in response to concern previously expressed by Commissioner Smitherman. Mr. Barry noted that, because past internal control issues had been resolved, the 2006 audit would only include a "normal" internal control review.

FAS 71 – Regulatory Accounting

Mike Petterson explained that, because it is good internal control practice, staff would continue to notify the Committee of important accounting assumptions, estimations, practices, and issues. To that end, he wanted to discuss applicability and specific accounting requirements of Statement of Financial Accounting Standards No.71 ("FAS 71") Accounting for the Effects of Certain Types of Regulation.

Mr. Petterson explained that FAS 71 is a fact-based accounting standard rather than a managerial choice and he summarized the main accounting concepts and requirements of the Standard. . Mr. Petterson noted that three key facts: (1) a prescriptive regulatory order, (2) an explicit balancing of expenditures and cost recovery mechanism, and (3) the creation of a discrete surcharge had led management to the conclusion that FAS 71 accounting must be employed by ERCOT commencing in 2006 for transactions relating to TNMIP. The Committee discussed and Mr. Karnei confirmed that this was an informational update and no Committee action was needed.

Annual Financial and Investment Standard and Charter Review

Cheryl Yager noted that staff had performed it annual review of the Financial Standard and Investment Standard and reviewed the proposed updates to the Standards with the Committee. The Committee discussed the proposed changes to the Standards.

Ms. Yager and Morgan Davies also updated the Committee regarding the intended modifications to the Credit Work Group Charter, noting that there were remaining issues regarding qualification of members and alternative members. Mr. Davies told the Committee that he expected to be able to bring the proposed Charter to the December meeting.

Bob Manning made a motion to recommend to the Board the approval of the revisions of the Financial Standard and the Investment Standard; William Taylor seconded the motion. The motion passed unanimously.

Interest Rate Risk Management and Derivatives

Ms. Yager and Mr. Byone updated the Committee on the interest rate swap the Board approved last year, noting that the swap was currently "in the money". Staff also reminded the Committee that a review of interest rates and ERCOT debt would be needed in early 2007 so that ERCOT could remain compliant with its Financial Standard requirement to limit un-hedged variable rate debt to not more than 40% of total debt outstanding.

Outage Scheduler Project Cancellation Q&A

Kent Saathoff, project sponsor of the Outage Scheduler Project, presented information on the project including circumstances that led the project team to cancel the outage scheduler development effort. In response to questions posed by members of the Committee, Mr. Saathoff provided clarifying comments to the satisfaction of the Committee.

Adjournment

At 9:58 A.M., the meeting was adjourned. The next Committee meeting will be held on the morning of December 12, 2006.

Susan Vincent, Secretary

Draft **MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING**
Austin Met Center
7:45 A.M.
October 17, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 7:45 A.M. on **October 17, 2006**. The Meeting was called to order by **Clifton Karnei** who ascertained that a quorum was present.

Meeting Attendance

Committee members:

Clifton Karnei, Chair	Brazos Electric Cooperative	Cooperative	Present
Miguel Espinosa, Vice Chair	Independent Board Member	Independent Board Member	Present
Robert Manning	H-E-B Grocery Co.	Consumer	Present
R. Scott Gahn	Just Energy	Ind. Retail Electric Provider	Present
Tom Standish	Centerpoint Energy	Investor-Owned Utility	Present
William Taylor	Calpine Corporation	Ind. Generator	Present

ERCOT staff and guests present:

Anderson, Troy	ERCOT
Barry, Sean (via phone)	PriceWaterhouseCoopers (PwC)
Berry, Ron	ERCOT
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Day, Betty	ERCOT
Doolin, Estrellita	ERCOT
Dreyfus, Mark	Austin Energy
Hancock, Misti	ERCOT
Hudson, Paul	PUCT
Jones, Sam	ERCOT (CEO)
Meek, Don	ERCOT
Petterson, Mike	ERCOT
Ruebsahm, Jamille	Deloitte & Touche (D&T)
Troxtell, David	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wullenjohn, William	ERCOT
Yager, Cheryl	ERCOT

Executive Session

At 7:46 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 8:40 AM. The Committee returned to Open Session at 8:45 AM.

Approval of Previous Minutes

Robert Manning moved to approve the minutes for the previous meetings held on September 19, 2006 and October 5, 2006; **Miguel Espinosa seconded the motion. The motion passed unanimously.**

2007 Operating Budget

Michael Petterson confirmed for the Committee the rigorous process of review of the proposed 2007 Operating Budget process to date, including review by and input from the public, market participants, PUCT staff, the Committee, and the ERCOT Board of Directors. Mr. Petterson overviewed the 2007 Budget objectives and assumptions and reviewed the proposed budget, including certain previously scrutinized expense items, outside services increase due to Nodal backfill by consultants, a comparison of the proposed budget to the 2004 to 2006 budgets, and a proposed 5-year forecast, all of which were set to be presented to the full Board. After discussions by the Committee members, Clifton Karnei confirmed that the Committee had reviewed the 2007 budget, generally concurred with management's recommendations and intended to make a recommendation regarding approval to the full Board during its November meeting. However, Mr. Byone and Mr. Karnei stated that they first wanted to discuss increasing the 2006 capital budget.

2006 Capital Budget Increase

Steve Byone explained that subsequent to an ERCOT staff review of the applications and systems that needed upgrade or other modification for the Texas Nodal Market Implementation Program, there was an outstanding question as to the inclusion of certain items in the Nodal budget. The items in question are critical path for Nodal and have been included in the Nodal program estimates although they were previously planned to be addressed (in later years) within the zonal capital program. Mr. Byone informed the Committee that management believes the interim surcharge Order contemplates separate accounting of specific Nodal costs versus costs that would be incurred under zonal. Mr. Byone stated that, based upon the analysis, ERCOT management suggested that $37 million of the proposed Nodal budget be reclassified to be a part of the traditional zonal capital projects budget ("Zonal").

Mr. Byone presented a proposal for implementing management's suggestion to reclassify the $37 million by: 1) Re-prioritizing Zonal project plans where possible, 2) Using anticipated 2006 "excess revenue" to fund project additions, 3) Temporarily decreasing 2007 equity contribution from 40% to 27%, and 4) Reducing 2008 Zonal project spending so that the overall (2006-2008) equity contribution target of 40% would be restored.

Mr. Byone explained that the proposed action would accommodate Nodal critical path items, maintain ERCOT's overall credit quality, and maintain a stable System Administration Fee in 2007 and 2008. He told the Committee that expected completion of items totaling $9.3 million in 2006 would require a 2006 spending increase, and that management would be seeking approval of this 2006 capital budget increase at the October Board meeting. Mr. Byone also stated that he would seek to have the Committee indicate approval of the 2007 Budget at the meeting but that no formal vote would be taken on the 2007 Budget until November.

Scott Gahn indicated support to reducing the equity percentage, temporarily, and asked Mr. Byone to confirm that non-Nodal staff members were involved in the reprioritization. Mr. Karnei asked if the Committee wanted to recommend the 2007 Budget at the upcoming meeting. William Taylor and Mr. Gahn questioned whether the Committee should wait until the November meeting to make a recommendation to determine if there was any change to the proposed $37 million reclassification. The Committee members indicated that they desired to retain a flat system administration fee. Robert Manning indicated that he would like to approve the 2007 Budget, and

Tom Standish stated that, although he didn't necessarily agree with the plan, he would agree to staff's financing proposal.

After extensive discussion, **William Taylor moved to recommend approval of the 2006 Capital Budget Increase of $9.3 million; Robert Manning seconded the motion. The motion passed unanimously.**

Treasury and Credit Update

Cheryl Yager presented to the Committee a Summary of Investment Results for the third quarter of 2006. She also informed the Committee that Moody's had reviewed its rating of ERCOT and had confirmed the current rating.

Ms. Yager updated the Committee on efforts to provide credit insurance coverage for the ERCOT market. Staff sought bids from five companies and continues discussion with two entities, one of which is fairly active at this time. She highlighted the parameters requested and the general pricing discussed with the vendor. She noted that all vendors had indicated that not all QSEs would be covered and that all vendors had cancellation clauses that would allow them to discontinue coverage on individual QSEs within certain notice timeframes. After some discussion, the Committee requested staff to provide more information so it could continue the discussions regarding the number of entities that the insurance would currently exclude, the notice required for and timing of future cancellations, how to fund the premium, and other related issues.

Ms. Yager noted that PRR 683, which was proposed by the Credit Work Group at the Committee's request, had been rejected by PRS. PRR 683 sought to reduce the timeline for notice and cure and create a working credit limit. TAC took no follow-up action. Staff interpreted the vote as acceptance by market participants of the residual credit exposure in the market. Mr. Karnei asked whether the Committee wanted to take action to reduce the credit risk. Mr. Taylor and Mr. Gahn noted that the market had clearly agreed to the current credit risk. After extensive discussion, the Committee asked staff to investigate possibly engaging a credit professional to assess the reasonableness of ERCOT's credit exposure policies and to bring further information to the Committee for review.

Deleted: engage

Deleted: whether the

Deleted: for ERCOT were reasonable

Ms. Yager updated the Committee on other Credit Work Group and credit staff projects including the following:

1. Reviewing business requirements for credit monitoring system for Nodal
2. Reviewing credit standards
3. Reviewing Credit Work Group charter
4. On-going review of PRRs
5. Automation of credit calculations

Discussion on Materiality Levels

Michael Petterson reviewed the benefits of establishing materiality levels and sought concurrence from the Committee regarding concepts of materiality that would promote more efficient design of a risk-based internal control program. Sean Barry of PwC agreed that this effort was a good idea and that it was best practice for the Committee and the Finance staff to agree on this topic. Mr. Barry also cautioned the Committee to avoid "pinning" itself down since materiality analyses are fact and circumstance driven. Mr. Barry and Bill Wullenjohn noted that internal audit and external auditors would have different thresholds for materiality, with internal audit using a lower threshold and external auditors using a higher threshold before disclosure. The Committee suggested staff prepare a document describing the materiality approach including relevant caveats.

Committee Briefs

Project Cancellation and Write-Off

Michael Petterson explained that the Outage Scheduler Enhancements Phase 2 Project had been cancelled and that 2006 operating expenses would be increased by $705,000. Committee members requested that the business owner (S. Myers) and/ or sponsor (K. Saathoff) be invited to a future meeting to explain the rationale for the cancellation.

Potential Conflicts – Market Participant Banks

Cheryl Yager requested the Committee to consider discussing during a future meeting the potential conflict or market participants that provide banking services to ERCOT.

Adjournment

At approximately 9:59 A.M., the meeting was adjourned. The next Committee meeting will be held on the morning of November 14, 2006.

Susan Vincent, Secretary

From: M. Petterson
To: Finance & Audit Committee
Date: December 5, 2006
Re: Approval of engagement of external auditors for other services

Objective

1. As required by the Finance and Audit Committee charter, alert members of the Finance and Audit Committee in writing that ERCOT has renewed for 2007 its subscription to Comperio, a comprehensive, web-based accounting database provided by PricewaterhouseCoopers, ERCOT's independent audit firm, costing approximately $2,000 per year.

Background

1. In early 2006, the Finance and Audit Committee amended its charter to include language consistent with the requirements established in Section 202 of Sarbanes-Oxley.
2. That Section of the law calls for preapproval from the Finance and Audit Committee for engagement of external auditors for "other services".
3. It was agreed at the time of the charter amendment that generally ERCOT staff should make the request for "preapproval" using the standard decision template (with other essential supporting documentation) used for Board and Board Committee meetings.
4. It was also agreed at the time of the charter amendment that engagements for "other services" totaling less than $5,000 should be communicated in writing to the members of the Finance and Audit Committee at the first meeting following the engagement for the "other services" at issue. This threshold amount is well below the de minimus exceptions provided for in Section 202.
5. Attached Exhibit 1 details the requirements of Section 202.

Exhibit 1 - The Sarbanes-Oxley Act of 2002, SEC. 202. PREAPPROVAL REQUIREMENTS.

(1) IN GENERAL. -

(A) AUDIT COMMITTEE ACTION. - All auditing services (which may entail providing comfort letters in connection with securities underwritings or statutory audits required for insurance companies for purposes of State law) and non-audit services, other than as provided in subparagraph (B), provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.

(B) DE MINIMUS EXCEPTION. - The preapproval requirement under subparagraph (A) is waived with respect to the provision of non-audit services for an issuer, if -

(i) the aggregate amount of all such non-audit services provided to the issuer constitutes not more than 5 percent of the total amount of revenues paid by the issuer to its auditor during the fiscal year in which the nonaudit services are provided;

(ii) such services were not recognized by the issuer at the time of the engagement to be non-audit services; and

(iii) such services are promptly brought to the attention of the audit committee of the issuer and approved prior to the completion of the audit by the audit committee or by 1 or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.

(2) DISCLOSURE TO INVESTORS. - Approval by an audit committee of an issuer under this subsection of a non-audit service to be performed by the auditor of the issuer shall be disclosed to investors in periodic reports required by section 13(a).

(3) DELEGATION AUTHORITY. - The audit committee of an issuer may delegate to 1 or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant preapprovals required by this subsection. The decisions of any member to whom authority is delegated under this paragraph to preapprove an activity under this subsection shall be presented to the full audit committee at each of its scheduled meetings.

(4) APPROVAL OF AUDIT SERVICES FOR OTHER PURPOSES. - In carrying out its duties under subsection (m)(2), if the audit committee of an issuer approves an audit service within the scope of the engagement of the auditor, such audit service shall be deemed to have been preapproved for purposes of this subsection.".

Interoffice Memorandum

To: Finance and Audit Committee
From: M. Petterson
Date: December 5, 2006
Re: ERCOT Financial Materiality

OBJECTIVE

Summarize and provide rationale, support, and background for management's conclusions regarding the type and size of transactions considered material to ERCOT's financial statements taken as a whole.

For purposes of this assessment, materiality is defined as a transaction or series of transactions that if inaccurately recorded may create substantial likelihood that the judgment of a reasonable person relying on ERCOT's financial reports would have been changed or influenced by the different accounting of the transactions.

CONCLUSIONS

Assessments of financial materiality should be conducted on a case-by-case basis considering pertinent situational facts. Any blanket statement regarding what constitutes financial materiality does not limit the company's ability to respond to specific situations and issues. Nonetheless, there are beneficial business purposes for making a generalized statement regarding financial materiality including the following:

1. Guide and demonstrate prudent fiscal management
2. Establish the "tone at the top" regarding internal control objectives – an important control in its own right
3. Communicate the importance of protecting the organization's reputation from the risks posed by erroneous financial accounting and financial statements
4. Ensure the establishment of cost beneficial internal control objectives by focusing resources on areas of higher risk
5. Help staff to evaluate and respond to key control exceptions such as
    a. Misstatement or error,
    b. Internal control deficiency,
    c. Accounting estimates, and
    d. Fraud.

Management expects that all transactions will be accurately, consistently, completely, and timely accounted for and, when consolidated, fairly present the company's financial position. Any direction, in general terms, as to what is "material" to the company's financial statements is not an excuse for sloppy accounting or poor control below established thresholds.

In addition, a generalized conclusion on financial materiality is not a substitute for prudent, attentive management. Management is expected to carry out materiality assessments on a case-by-case basis considering qualitative factors (certain activity must be considered material regardless of the quantitative impact) and quantitative measures (established dollar thresholds are just one factor of many to be considered.

Several qualitative considerations that might be important in materiality assessments include the following:

- Does the transaction have a significant impact on the ERCOT System Administration Fee?
- Does the transaction mask a financial trend?
- Does the transaction change an income into a loss or vice versa?
- Does the transaction affect regulatory compliance?
- Does the transaction have the effect of increasing management compensation?
- Does the transaction affect compliance to loan covenants?
- Does the transaction involve concealment of unlawful transactions?
- Does the transaction have impact on the volatility of ERCOT's securities?
- Has management intentionally misstated items in the financial statements to "manage" reported earnings?
- Does the transaction significantly alter the total mix of financial information made available?

There are rule of thumb measures for materiality, such as 1 percent of revenue or operating expenses. ERCOT's important public service responsibilities affect materiality assessments by requiring relatively higher standards of performance and relatively lower quantitative thresholds. As a result, applying such rule of thumb measures at ERCOT would establish thresholds of materiality which have been deemed too high.

Considering ERCOT's public service responsibilities, recent events and history, and pertinent qualitative and quantitative issues, ERCOT management believes that transactions representing more than 0.25 percent of total company revenue or 5 percent of minimum operating expense line items on its statement of activities (approximately $350,000 or $0.0011 per MWh) should be considered material – whether occurring as a single transactions or combination of transactions. Transactions of such magnitude, if inaccurately recorded, may create substantial likelihood that the judgment of a reasonable person relying on ERCOT's financial reports would have been changed or influenced by the different accounting of the transactions.

Transactions that approach or exceed the general thresholds for materiality or which require unusual management interpretation or estimation will be communicated to senior management and members of the Finance and Audit Committee of the Board as appropriate.

RATIONALE, SUPPORT, AND BACKGROUND

ERCOT is a non-profit entity subject to regulatory oversight by the Public Utility Commission of Texas. ERCOT is a breakeven entity and its fees are established to recover its costs of operations or revenue requirements which can be summarized into three categories:

1. Operating and maintenance expenses,
2. Debt service obligations (principal and interest), and
3. A portion of capital project expenditures (approximately 40 percent for planning purposes).

ERCOT is designed, structured, and organized to generate little if any net income or net unrestricted assets (equity). Financial ratios based on net income or net unrestricted asset figures are a secondary consideration to users of the company's financial statements.

The definition of materiality as established above makes important reference to the conclusions and actions that users of ERCOT's financial statements make in response to the financial statements. Users of ERCOT's financial statements have generally demonstrated greater interest in ERCOT's relationship with the PUCT and the company's ability to recover fees sufficient to allow repayment of debt service obligations and operating expenses than they have with net income and profitability measures. As a result, in deriving its conclusions management places heightened importance on qualitative factors and quantitative ratios relating to total assets and total expenses.

As a result of its organization as a cost pass-through, not for profit organization, subject to regulatory oversight, ERCOT management believes that many traditional, financial measures of materiality may not be appropriate for the assessment of materiality in connection with ERCOT's financial statements. The situation again leads management to place heightened importance on qualitative factors and quantitative ratios relating to total assets and total expenses when evaluating materiality issues.

DRAFT

Proposed Agenda for Credit Workshop
7620 Metro Center Drive
January 2006*

Agenda Item #	Description/Purpose/Action Required	Presenter	Time
	Call to Order	TBD	TBD
1.	Overview of legal / policy directives regarding financial stability of the ERCOT market (e.g. credit issues)	TBD	TBD
	• Legal considerations	TBD	TBD
	• Other considerations	TBD	TBD
2.	What is ERCOT, Inc. and the ERCOT Board of Director's role with respect to credit in the ERCOT market?	TBD	TBD
3.	How to maintain the right environment	TBD	TBD
	• Establish a standard of measure (what is the goal?)	TBD	TBD
	• Determine how to balance financial stability with potentially competing goals (i.e. market liquidity, barrier to entry issues)	TBD	TBD
	• Maintain or establish processes or governance structures to accomplish goal (i.e. Credit WG governance, etc)	TBD	TBD
	• Other	TBD	TBD
4.	Review current level of credit exposure	TBD	TBD
	• Amount	TBD	TBD
	• Parties bearing risk	TBD	TBD
5.	How to determine how much credit risk is too much? Or how to determine that the market is "financially stable"?	TBD	TBD
	• Market Opinion	TBD	TBD
	– TAC	TBD	TBD
	– Credit Work Group	TBD	TBD
	• ERCOT Staff Opinion	TBD	TBD
	• Third party independent assessment	TBD	TBD
	• Other/PUCT	TBD	TBD
6.	Next steps	TBD	TBD
	Adjourn	TBD	TBD

Action Items

- Review proposed agenda
- Confirm meeting date and time allocation

TNMIP accounting must –

- be consistent consist with Generally Accepted Accounting Principles as well as approved ERCOT policies, standards, and procedures
- demonstrate efficient and prudent use of resources to deliver benefits of the nodal market to the citizens of Texas
- support decision making by TNMIP program management, ERCOT management, and the ERCOT Board among others
- facilitate regulatory proceedings and cost recovery

- All TNMIP costs are charged to one of 14+ subprojects required by the program team
  - Direct
  - Allocated

- All TNMIP costs are categorized as either
  - Capital investment
  - Operating expense

- $37 million of “zonal” projects
  - Managed as part of TNMIP
  - Charged to discrete accounting codes
  - Removed from cost assumed recovered via the Nodal Surcharge

Accounting Highlights – Nodal & IMM
Mike Petterson

Account Category	Type	Summarized Accounting Treatment
Revenue	Direct	Separate revenue account relating to the $0.0663 TNMIP surcharge.
Labor	Direct	Based on hours recorded and approved in ERCOT's time tracking system.
Consultants and contractors	Direct	Based on vendor invoice and/or purchase order and contract documents.
Hardware and software support and maintenance	Direct	Based on vendor invoice and/or purchase order and contract documents.
Tools, materials, equipment, and supplies	Direct	Based on vendor invoice and/or purchase order and contract documents.
Insurance	Direct	Based on vendor invoice and/or purchase order and contract documents.
Property taxes	Direct	Based on vendor invoice and/or purchase order and contract documents.
Reimbursable business expenses	Direct	Based on approved request for business expense reimbursement.
Other	Direct	Based on vendor invoice and/or purchase order and contract documents. Costs likely to be incurred include printing and off-ERCOT premises meeting space.
Hardware and software procurement	Direct	Based on vendor invoice and/or purchase order and contract documents.
Minor capital purchases	Direct	Based on vendor invoice and/or purchase order and contract documents.
Facilities, maintenance, and utilities	Indirect	Based on actual historical cost of operating and maintaining ERCOT facilities and estimated square footage used by TNMIP staff. Credit given for higher than typical staff density in TNMIP work rooms. Allocated monthly.
Support services	Indirect	Based on actual historical labor costs incurred by support service departments relative to total ERCOT spending. Allocated monthly.
Staff backfill differential	Indirect	Based on monthly comparison of the cost of the backfill resource now performing a task and the cost of the employee formerly performing the task now working on TNMIP. Relocation and recruitment costs are considered in the analysis.
Interest expense	Indirect	Based on spending on the TNMIP effort and ERCOT's estimated cost of long-term borrowing. Allocated monthly.
Depreciation and amortization	Indirect	Systematic calculation based on assets acquired or developed in connection with TNMIP. Expense begins at the time assets are placed into service.

From: M. Petterson
To: Finance & Audit Committee
Date: December 5, 2006
Re: Accounting for the Texas Nodal Market Implementation Program

Objective

1. Summarize the accounting practices that will be used to capture and report the costs of supporting the Texas Nodal Market Implementation Program (TNMIP).

Practices

In relation to ERCOT's TNMIP effort it will be necessary for accounting records to distinguish program costs in two important ways:

(1) costs that should be treated as capitalized investment and depreciated over time versus those that should be treated as operating expense in the current accounting period and

(2) costs that should be recovered via the approved Nodal Surcharge versus those that should not.

Capital Investment versus Operating Expense - Accounting rules and ERCOT policies do not leave much latitude for discretion regarding the capitalization of expenditures. Accounting staff will continue to evaluate company expenditures, including those relating to the TNMIP, to ensure accounting treatment is consistent with accounting principles generally accepted in the United States of America, such as Statement of Position 98-1 (SOP 98-1) Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, and approved company policies, standards, and procedures.

Nodal Surcharge Recovery versus Alternative Recovery Method - The issue of identifying the costs that should be recovered via the Nodal Surcharge is more subjective, and as a result, in many ways, more complicated. In October, TNMIP staff and ERCOT accounting staff worked with consultants from Sirius Solutions, L.L.L.P. to produce a document to guide accounting for TNMIP transactions. The document (attached) establishes the framework ERCOT staff will employ in accounting for the project and seeking reimbursement via the Nodal Surcharge.

Attachment: ERCOT Nodal Market Surcharge, Project Cost Methodology, October 30, 2006.

ERCOT Nodal Market Surcharge
Project Cost Methodology

1. Background

In Docket Number 32686, the Electric Reliability Council of Texas (ERCOT) filed an application with the Public Utility Commission of Texas (PUCT) for the approval of a Nodal Implementation Surcharge (NIS). Nodal refers to The Texas Nodal Market Implementation Program (TNMIP), which exists to facilitate the transition from a Zonal market, currently divided into five (5) Congestion Management Zones, to a Nodal market with more than four thousand (4000) nodes. The surcharge was approved via an interim order to fund the cost of implementation of the Nodal market and the payment by qualified scheduling entities (QSE's) representing generation. The separate funding source for the Nodal surcharge requires accounting changes within ERCOT to separate costs funded under the System Administration Fee (SAF) which is used to pay for the ongoing operations of ERCOT. Heretofore, the vast majority of all ERCOT costs were funded under the SAF paid by QSE's representing load only. With costs now being shared by two constituencies, ERCOT is faced with making a determination of fairly and reasonably apportioning costs between them. This issue is the subject of this report.

ERCOT has engaged Sirius Solutions LLLC ("Sirius") to perform certain tasks as part of ERCOT's internal process to respond to the PUCT's order to validate or change the interim Nodal surcharge. This report was prepared for that purpose and is to be used for review by ERCOT and the PUCT in order to set forth a framework for the apportionment of these costs by identifying which costs should be reasonably recovered under the Nodal surcharge. As part of this engagement, Sirius performed the following tasks:

a) Obtained an understanding of ERCOT's costs, general ledger and cost accounting structure;
b) Reviewed existing cost allocation frameworks and concepts developed by ERCOT Finance/Accounting personnel and ERCOT's Texas Nodal implementation Program team;
c) Reviewed PUCT rules and regulations applicable to ERCOT specifically or electric utilities cost allocation generally;
d) Identified all (directly) assignable costs for each general ledger (or sub-ledger) account;
e) Determined a reasonable and efficient factor (or factors) and method by which to allocate directly allocable costs;
f) Determined a reasonable and efficient factor (or factors) and method by which to apportion indirectly "apportionable" costs;
g) Drafted a preliminary ERCOT cost allocation manual; and,
h) Prepared an assessment of additional studies and work to be completed to finalize the cost allocation manual for audit and/or presentation to the PUCT.

This report sets forth a cost allocation framework of the Nodal implementation program to be considered by the PUCT, included within the Nodal surcharge filing scheduled to be delivered to the PUCT on November 27, 2006. However, neither this report nor the scope of the engagement

should be construed to be a full cost causation analysis or cost study of the budget needed for delivering the Nodal Program. Given the subjective nature of the issues involved in the allocation of costs for programs such as the Nodal transition, we do not believe the costs of such a study would benefit ERCOT or the PUCT.

2. Executive Summary

Although the financial reporting for a program such as the Nodal implementation is reasonably well defined by Generally Accepted Accounting Principles (GAAP), the rules associated with project costing and related allocations are not. Our review of publicly available rate filings suggests there is a diverse practice in approach to program/project cost methodology and funding. Our research also indicates there is a lack of authoritative accounting guidance to support any specific framework.

In planning this work, we evaluated three alternative approaches for tracking of ERCOT's Nodal Program costs:

1. Direct Cost
2. Incremental Cost
3. Fully Distributed Cost

Direct Cost – This approach would consider only those costs directly related to the Nodal Program. This is a framework whereby only costs such as external labor or hardware are considered a part of the Nodal Program. This approach was not selected because it was determined that it was not an accurate reflection of the total costs associated with the Nodal Program, as it did not include significant labor components and other indirect costs.

Incremental Cost – This approach would assume only those costs incurred above and beyond the ongoing operating costs of ERCOT as a whole would be recovered under the Nodal surcharge. Although this framework more closely represented actual Nodal Program costs, it was not selected because it did not reflect the cost of certain internal ERCOT resources dedicated as part time or full time program resources. It also ignored certain shared labor and indirect costs.

Fully Distributed Cost – This approach considers all costs related to the Nodal Program whether they are external or internal in nature. This framework was selected because it more accurately reflects the actual resources devoted by ERCOT and utilized by the Nodal Program.

At its essence, the Nodal Program is a discrete program with a defined start and end. More precisely, it is a set of individual projects or functional work streams that are managed jointly as a program in support of the transition to a Nodal market scheduled to "go live" on December 8, 2008. As of September 2006, the ERCOT Nodal team estimated the Nodal implementation costs to be $263 million. ERCOT management is aware that some of this amount relates to projects which would have been undertaken irrespective of the transition to a Nodal market, since there were certain upgrades to the ERCOT technology infrastructure which would have occurred even if ERCOT had remained Zonal. Since there are interdependencies between these Zonal projects and the Nodal Program, they must be managed together with the Nodal transition to mitigate overall program delivery risk, as well as for efficiency purposes. However, only the costs directly attributable to the Nodal Program should be included in the Nodal surcharge. This will be discussed in detail later in this report.

After completion of this report, ERCOT intends to revise its estimate of costs which should be funded by the Nodal surcharge.

3. ERCOT's Cost Tracking and Fee Collection

ERCOT has implemented certain controls around the tracking and managing of Nodal Program costs. They believe these controls are consistent with all approved ERCOT policies, standards and procedures. Each of the individual Nodal projects, or "work streams", is led by a project manager who is responsible for monitoring their portion of costs against budget. Reports are provided by ERCOT accounting to the project managers for review to insure that cost data for their respective projects is monitored.

A separate accounting ledger has been created in ERCOT's accounting system for the Nodal Program to insure that tangible (hardware/software) and intangible (time) costs for the program are recorded separately from ERCOT's day to day operational costs.

For time costs, all ERCOT employees assigned to the Nodal Program record hours worked in the time tracking system against a specifically approved project and activity. For hardware, software and other purchases necessary to implement the Nodal Program, the standard ERCOT procurement and accounts payable processes will continue to be in effect, but coding is to the separate Nodal accounting ledger.

The Nodal Program Management Office will have overall responsibility for insuring that each individual project in the program is delivered in a timely fashion as well as monitoring the overall program budget. The Nodal Program Management Office has already passed an IBM Project Controls audit, which assessed the program's financial and project management controls. Further, Sirius understands there will be audits of the program by IBM and ERCOT internal audit staff conducted at regular intervals to be determined by ERCOT management.

The funding mechanism for the Nodal Program is the Nodal Implementation Surcharge ("NIS"), which is paid by QSE's representing generation. This charge is calculated based on net metered generation as defined in the Nodal protocol sections 9.4.4 and 9.7.7, as amended by PRR 688 to comply with the Final Order issued in PUCT, Docket No. 32686, Application of the Electric Reliability Council of Texas for Approval of a Nodal Market Implementation Surcharge and Request for Interim Relief. ERCOT shall calculate the NIS by multiplying total net metered generation by a Nodal surcharge factor. The Nodal surcharge factor will be a flat rate as authorized by the PUCT. The NIS will appear as a separate Market Service on the Settlement Statement. ERCOT shall charge the NIS on a daily basis, broken down by the appropriate quantity per settlement interval. QSE total net metered generation will be the total of the net metered generation aggregated to the QSE level. ERCOT will charge the NIS until it has recovered the full cost of implementing the Nodal market redesign, at which time the NIS will end.

The budget amounts estimated by ERCOT will be revised from time to time based on project progress and actual costs as they become known. This could cause a change in the NIS over the time of the transition.

4. Nodal Program Costs

The fully distributed costing framework described in this report is based on the fact that both direct and indirect costs can be identified based upon the activity to which the costs were intended

to benefit. In general, we believe that it is appropriate that the cost of the Nodal program (and the cost to be recovered through the Nodal surcharge) include all actual costs – direct and indirect attributable to implementing the Nodal protocols.

Nodal Program personnel have classified program costs into four categories, as follows, the amounts of which are set forth in Table 4-1 below.

- Internal labor - ERCOT employee time and related overhead
- External labor - Contractor/consultant time and billings
- Vendor labor - Software vendor time and effort
- Hardware/Software/Miscellaneous costs

	Nodal Program Projects	**Internal Labor**	**External Labor**	**Vendor Labor**	**Hardware & Software**	**Total**
1	Program Mgt Office	$222,300	$3,851,440	$3,000,000	$27,415	$7,101,155
2	Integration and Design Authority	$1,020,825	$3,855,940	$0	$1,893,961	$6,770,726
3	Network Model Mgt System	$1,045,200	$1,372,600	$10,121,621	$150,000	$12,689,421
4	Energy Mgt System	$4,333,160	$794,565	$10,104,225	$2,259,000	$17,490,950
5	Market Mgt System	$3,409,120	$6,007,200	$13,500,000	$3,355,000	$26,271,320
6	Congestion Revenue Rights	$1,065,480	$1,800,840	$792,000	$2,600,186	$6,258,506
7	Commercial Systems	$5,561,400	$5,112,200	$3,905,235	$200,000	$14,778,835
8	Enterprise Integration	$2,917,200	$7,799,200	$0	$1,607,460	$12,323,860
9	Enterprise Data Warehouse	$2,492,800	$1,544,000	$0	$0	$4,036,800
10	Infrastructure	$2,191,800	$5,547,520	$1,759,300	$52,341,787	$61,840,407
11	Integration Testing	$4,691,272	$11,349,461	$0	$936,650	$16,977,383
12	MP Engagement and Readiness	$4,503,850	$11,394,780	$4,377,209	$1,268,039	$21,543,878
13	ERCOT Readiness and Transition	$13,133,224	$16,146,615	$0	$0	$29,279,839
	Project Subtotals	$46,587,631	$76,576,361	$47,559,590	$66,639,498	
14	Finance Charge (4%)					$10,600,000
15	Contingency (6%)					$15,000,000
					Total Cost of Nodal	**$262,963,080**

Table 4-1: ERCOT Estimate by Nodal Program Project

> Note: Each of the Nodal Program projects (or work streams) is described more fully in Exhibit 1. This Exhibit sets forth a brief description of each project in the above table, the key deliverables and estimation assumptions.

As a part of this engagement Sirius reviewed a number of internal ERCOT reports and documents, including ERCOT accounting ledgers, ERCOT financial statements, detailed Nodal

budget estimates, and summarized vendor RFP responses. The purpose of this review was to identify the nature of costs allocable to the Nodal effort and suggest a framework for apportionment of these costs for ERCOT's determination of the Nodal surcharge. Within the work streams shown in Table 4-1, we found varying cost types. These are set forth in Table 4-2 below and consist of direct and indirect, as well as internal and external costs.

The direct costs are easily discerned and can be charged directly to the program ledgers. They consist of third party vendor billings for items such as consultant time, hardware, and software. They are also specific to the Nodal Program projects listed in Table 4-1. Furthermore, there is not a great deal of judgment involved as to their inclusion or amount in the Nodal surcharge. Indirect costs are more difficult to discern. By their nature, they are not easily identifiable within the Nodal Program because they consist of items such as ERCOT employee time charged to the program on a part-time basis and shared services (e.g. legal, accounting, facilities, etc.). As a practical matter, there is no question on a fully distributed cost basis as to their inclusion. However, there will be judgment required in determining the apportioned amounts. Table 4-2 below reflects the cost types which we recommend be charged to the Nodal Program. Each is identified as direct or indirect and the allocation base is stated or reference is made to where the allocation methodology is discussed in this report.

Cost Type	Direct or Indirect	Allocation Base
Labor		
ERCOT Dedicated / Part-Time	Direct	See Section 5.1 Actual payroll plus burden
ERCOT Part-Time	Indirect	see Section 5.1
ERCOT Shared(Support Services)	Indirect	see Section 5.3
Supplies	Direct	Third party invoices
Contractors	Direct	Third party invoices and contracts
Hardware	Direct	Third party invoices
Software	Direct	Third party invoices
Hardware support	Direct	License/Maintenance Agreements
Software support	Direct	License/Maintenance Agreements
Facilities	Indirect	see Section 5.2
Finance charges	Direct	see Section 5.9
ERCOT Training costs	Direct	Actual payroll plus burden
Contingency	Direct	see Section 5.10

Table 4-2: Cost Types within Nodal Program Projects

5. Adjustments and Allocation Frameworks

As indicated above, all estimates comprising the Nodal budget are based on third party RFP's, estimates of direct internal labor hours and rates, and allocations of internal costs. ERCOT accounting systems are capable of capturing actual costs and these estimates will be adjusted accordingly as the actual amounts become known. The actual costs of the Program may vary materially from the current program budget, which may impact the amount of the surcharge.

ERCOT, as represented by the Nodal Program office, will revise its program cost forecast monthly and report the same to the PUCT as often as the PUCT dictates. Actual costs (internal and external), hardware and software costs will be recorded to the Nodal Program's accounting books as these costs are incurred.

In the context of funding, there are a number of considerations which impact the amount which should be recovered in the surcharge. This section of the report sets forth those matters, of which we have become aware, and describes certain allocation frameworks for consideration in determining the final program funding by the surcharge.

5.1. Labor Rate

ERCOT has estimated the fully burdened labor rate to be $65/hour for ERCOT staff. Sirius reviewed the components that were included in the $65/hour labor rate with Michael Petterson, ERCOT Controller, and determined that the labor rate was reasonable for use in project planning and budgeting and the components contained therein were reasonable. While we recognize this amount is an estimate, there is a wide variation in the skill level of internal resources and each individual Nodal Program project should reflect that difference. ERCOT accounting personnel are working with the Nodal PMO to identify internal resources by name, and may revise the labor rates to each project accordingly, if actual labor costs are materially different than the estimates.

As a matter of reference, the categories of labor involved in the Nodal Program are: dedicated and part-time (direct charged to the Nodal Program) or support services (allocated as an indirect charge to the Nodal Program).

Dedicated and part time labor costs will be charged to the Nodal projects each month based on actual pay rates of employees contributing to the Nodal program and the hours recorded to various Nodal project tasks by ERCOT employees. The hours recorded to the Nodal projects are also approved by ERCOT employee managers and confirmed by Nodal project managers.

ERCOT Accounting will report overall hours charged to the Nodal Program by employee by pay period, as well as a lump sum labor cost by project within the program. This will allow accurate reporting of actual program labor costs, while protecting the confidentiality of individual ERCOT employee salaries. The Nodal PMO will insure that time charged to the project will be captured accurately and timely, and will review the summary time reports from ERCOT Accounting. The Nodal PMO is responsible for reporting issues and discrepancies, as well as requesting prior period adjustments as needed to insure accuracy and completeness of time reporting.

The allocation of Support Services labor costs is addressed in Section 5.3.

Consistent with our recommendation that the Nodal program costs should include direct as well as indirect expenses, we believe ERCOT plans to directly charge labor to the Program as well as allocate a portion of support services labor is a reasonable approach.

5.2. Facilities Framework

Facilities (overhead) charges could be determined in a number of acceptable ways using a number of factors. Example frameworks include: flat fee, square-footage occupancy, or a "seat "charge, etc. We suggest a square footage method, where the allocation is based on the average square

footage consumed by Nodal Program personnel and the average cost of maintaining ERCOT facilities and systems.

Facilities charges will be allocated to the Nodal Program following the steps summarized below.

1. Accounting staff will periodically compute ERCOT's average costs of maintaining its facilities by dividing total facilities costs by the total number of square feet in its facilities.
2. Accounting staff will periodically compute the average square footage consumed by an ERCOT FTE.
3. Accounting staff will periodically compute the average square footage of space consumed by the limited number of FTEs located in the Nodal Program team rooms. Given the relatively short term nature of the Nodal program and space needs of the project team coupled with the desire to have project team members working in close proximity to one another, many members of the project implementation team are arranged in work rooms of significantly higher density than normal ERCOT office space.
4. Accounting staff will periodically determine the maximum number of FTEs that can be accommodated in the high-density Nodal program team rooms.
5. Accounting staff will compute the number of FTEs working on the Nodal program each month based on hours submitted by ERCOT employees and a count of contractors and consultants on site in connection with the Nodal program.
6. Accounting staff will compute the average square footage of ERCOT office space consumed by FTEs contributing to Nodal projects assuming the high-density Nodal team rooms are filled to capacity. Accounting staff will multiply the average cost per square foot of maintaining ERCOT facilities by the average square footage of ERCOT office space consumed by FTEs contributing to Nodal projects assuming the high-density Nodal team rooms are filled to capacity.

5.3. Support Services Framework

The current $263MM Nodal Program budget does not reflect a detailed estimate of the support costs necessary for services such as: Executives, Legal, Accounting, Human Resources, Procurement, etc. Example acceptable frameworks include flat fee, shared service percentage, transaction-based, time-based, etc. We believe the most acceptable and efficient method is based on a pro rata percentage of total Support Services operating expense as compared to total ERCOT spending authorization. Spending authorization includes both capital project expenses as well as operating expenses. These amounts are reported each April in ERCOT's yearly financial statements. This pro rata percentage would be set each year when the final financial statements are released to the PUCT, and be in effect until the following April, when the next year's financial statements are similarly released.

> Monthly Support Services Allocation = (Operating Expenses for Legal, Accounting, HR, Procurement and Executives / Total ERCOT Spending Authorization) * Monthly Nodal budget

5.4. Network Model Management System (NMMS)

The NMMS Project was underway before the Nodal Program commenced. Now that the Nodal Program exists, the NMMS scope has increased to accommodate Nodal-specific requirements. Although much of the NMMS development and all of the State Estimator/Network Model fidelity work is for the Zonal market (with benefit continuing after the move to the Nodal market), the balance is Nodal related.

Inclusion of NMMS costs currently in the $263MM budget should only be associated with the scope changes attributed to the Nodal Program. The basis for the NMMS Zonal Cost is a recommendation made to the ERCOT Board of Directors by Steve Byone, ERCOT Vice President and CFO, on October 17, 2007. The Nodal Program Team, in concert with ERCOT operations managers, made this determination by reviewing each NMMS requirement and assigning it as either being required by the Nodal market or Zonal market, and then removing the corresponding estimated cost to implement from the NMMS budget. The NMMS Zonal cost was determined to be approximately $12MM.

NMMS Nodal Cost = $12,689,421 -NMMS Zonal Costs

NMMS Nodal Cost = $12,689,421 – 12,000,000 = $689,421

5.5. Energy Management System (EMS)

The EMS Project was also underway before the Nodal Program. Now that the Nodal Program exists, EMS scope has increased to accommodate Nodal-specific requirements. Although much of the EMS development is for the Zonal market, the balance is Nodal related.

Inclusion of EMS costs currently in the $263MM budget should only be associated with the scope changes attributed to the Nodal Program. The basis for the EMS Zonal Cost is a recommendation made to the ERCOT Board of Directors by Steve Byone, ERCOT Vice President and CFO, on October 17, 2007. The Nodal Program Team, in concert with ERCOT operations managers, made this determination by reviewing each EMS requirement and assigning it as either being required by the Nodal market or Zonal market, and then removing the corresponding estimated cost to implement from the EMS budget. The EMS Zonal cost was determined to be approximately $8MM.

EMS Nodal Cost = $17,490,950 - EMS Zonal Cost

EMS Nodal Cost = $17,490,950 – 8,000,000 = $9,490,950

5.6. Infrastructure (INF) Adjustment

The INF project was underway before the Nodal Program, as well. Now that the Nodal Program exists, INF scope has increased to accommodate Nodal-specific requirements. In this case, only enhancements were necessary to the networking infrastructure to meet the Nodal requirements. The UNIX end-of-life, the data center virtualization and the EDW storage, Oracle support and hardware were previously Zonal market related.

Inclusion of Infrastructure costs currently in the $263MM budget should only be associated with the scope changes attributed to the Nodal Program. The basis for the Infrastructure Zonal Cost is a recommendation made to the ERCOT Board of Directors by Steve Byone, ERCOT Vice President and CFO, on October 17, 2007. The Nodal Program Team, in concert with ERCOT operations managers, made this determination by reviewing each Infrastructure requirement and assigning it as either being required by the Nodal market or Zonal market, and then removing the corresponding estimated cost to implement from the Infrastructure budget. The Infrastructure Zonal cost was determined to be approximately $17MM.

INF Nodal Cost = $61,840,407 - INF Zonal Cost

INF Nodal Cost = $61,840,407 - $17,000,000 = $44,840,407

5.7. Nodal Program Start Date

ERCOT was in a position to capture Nodal Program costs in January of 2006, with first actual costs being incurred in February of 2006. This allowed ERCOT to commence planning for the Nodal Program although final approval for the Nodal market protocols occurred in PUCT Docket Number 31540 dated on April 5, 2006. Based on a review of costs incurred prior to April 5, ERCOT's commencement date appeared reasonable.

5.8. Nodal Program End Date

The Nodal market in Texas is scheduled to be implemented on December 8, 2008. As with any large software and hardware project, there will be post implementation costs associated with the Nodal Program. These costs include additional training, follow-on enhancements, "bug" fixes or other code remediation. We recommend these costs be estimated by ERCOT and included in the Nodal surcharge.

5.9. Finance Charge Adjustment

ERCOT's originally estimated finance charge is approximately 4% of the entire program budget.

While this calculation may be acceptable for budget purposes, the actual finance charges should be based on actual debt incurred to finance the program costs versus the funding actually recovered under the Nodal surcharge. The true financing costs will be determined by calculating the monthly cash inflow from the Nodal surcharge versus the cash outlays for program costs based in part on the payment terms negotiated with the corresponding vendors, while using the actual ERCOT borrowing rate in effect over the cost recovery period. This is presently approximately 6%; this rate should be used to calculate the interest expense for purposes of establishing the Nodal surcharge. The financing cost of the program will be handled the same as other cash outlays for the program, and included in the total cost. Interest costs will be calculated by ERCOT on this basis after the revisions described in this section. The total financing cost given the expected cost recovery period will be significantly higher than the originally estimated finance charge.

5.10. Contingency Adjustment

ERCOT has established a project contingency of 6%; we believe this is on the low end of an acceptable range for this project. Due to the size and complexity of the Nodal Program, a contingency of up to 20% or more could be justified to account for the lack of firm business requirements at this early stage of the program. Given the fact that ERCOT will monitor budget-to-actual on a monthly basis, this amount can be adjusted as necessary when actual amounts are incurred.

6. Summary

In summary, we believe ERCOT has made a reasonably thorough estimate of its Nodal Program cost. While there could be changes to these initial estimates or methodologies as discussed in Section 5 above, the incorporation of a mechanism to adjust the surcharge rate during the transition process would improve the probability that costs collected under the surcharge are reasonably inclusive.

Exhibit I – Supporting Detail for Nodal Program Costs

1. Program Management (PMO)

The Program Management (PMO) project provides program leadership, organization, mobilization, strategic planning and delivery assurance. PMO is meant to deliver the following:

- Program organization & governance
- Program charter
- Program management corporate standard & operating procedures
- Integrated plans, controls and reporting
- Program risk management
- Executive stakeholder management

The Nodal Program estimated cost of PMO is $7.10MM as follows:

PMO	**$**
Internal Resource Costs	$222,300
External Resource Costs	3,851,440
Vendor Labor	3,000,000
Hardware, Software, misc.	27,415
Total	**$7,101,155**

Table 1: PMO Cost Summary

2. Integration & Design Authority (IDA)

The Integration & Design Authority (IDA) project consists of the business architecture and technical architecture for the program and the design standards and design assurance for the program. IDA is meant to deliver the following:

- Overall business and technical architecture
- Guidance on contracts and Vendor selection
- Strategies & Roadmaps for Integration, Enterprise Data Warehouse, MIS, hardware, security, database hosting, User Interface design, XML standards
- Rational Unified Process (RUP) artifacts and training
- Technical architecture assistance
- Quality Assurance (QA)
- Requirements traceability
- User Interface Standards

The Nodal Program estimated cost of IDA is $6.77MM. as follows:

IDA	**$**
Internal Resource Costs	$1,020,825
External Resource Costs	3,855,940
Vendor Labor	-
Hardware, Software, misc.	1,893,961
Total	**$6,770,726**

Table 2: IDA Cost Summary

3. Network Model Management System (NMMS)

The Network Model Management System (NMMS) project provides the capability to generate Planning and Network Models for Real-Time, Day-Ahead and Future applications and studies. NMMS is meant to deliver the following:

- Naming Conventions
- State Estimator Criteria
- Network Modeling & Telemetry (proof of required fidelity)
- Requirements for TPTF approval
- Conceptual System Design for TPTF approval
- Time based Network Operations and Planning Model Management System

The Nodal Program estimated cost of NMMS is $12.69MM. as follows:

NMMS	**$**
Internal Resource Costs	$1,045,200
External Resource Costs	1,372,600
Vendor Labor	10,121,621
Hardware, Software, misc.	50,000
Total	**$12,689,421**

Table 3: NMMS Cost Summary

4. Energy Management System (EMS)

The Energy Management System (EMS) project implements the necessary changes to ERCOT's current Energy Management System (EMS), implements the new Renewal Production Potential (RPP) function, and upgrades the current ERCOT EMS. EMS is meant to deliver the following:

- Requirements for TPTF approval
- Conceptual System Design for TPTF review
- EMS platform upgrade & ERCOT customizations
- Network Security upgrade and Load Frequency Control
- Migration of enhanced Zonal Load Forecast to Nodal
- New RPP

The Nodal Program estimated cost of EMS is $17.49MM as follows:

EMS	$
Internal Resource Costs	$4,333,160
External Resource Costs	794,565
Vendor Labor	10,104,225
Hardware, Software, misc.	2,259,000
Total	**$17,490,950**

Table 4: EMS Cost Summary

5. Market Management System (MMS)

The Market Management System (MMS) project provides business processes and systems for the Nodal Real-Time and Day-Ahead Energy and AS Markets and Outage Scheduler. MMS is meant to deliver the following:

- Requirements for TPTF approval
- Conceptual System Design for TPTF approval
- Day Ahead Market capability
- Supplemental AS Market capability
- Reliability Unit Commitment capability
- Security Constrained Economic Dispatch (Real Time Market) capability
- DC Tie
- Data for Wholesale Market Monitoring
- Outage Scheduler

The Nodal Program estimated cost of MMS is $26.27MM as follows:

MMS	$
Internal Resource Costs	$3,409,120
External Resource Costs	6,007,200
Vendor Labor	13,500,000
Hardware, Software, misc.	3,355,000
Total	**$26,271,320**

Table 5: MMS Cost Summary

6. Congestion Revenue Rights (CRR)

The Congestion Revenue Rights (CRR) project provides business processes and systems to allow CRR Owners to be charged or receive compensation for congestion rents that arise when the ERCOT Transmission Grid is congested in the Day-Ahead Market (DAM) or in Real-Time. CRR is meant to deliver the following:

- Requirements for TPTF approval, Conceptual System Design for TPTF approval
- PCRR and MCFRI allocation capability
- CRR auction capability
- CRR ownership tracking capability and Bilateral trading capability

The Nodal Program estimated cost of CRR is $6.26MM.

CRR	$
Internal Resource Costs	$1,065,480
External Resource Costs	1,800,840
Vendor Labor	792,000
Hardware, Software, misc.	2,600,186
Total	**$6,258,506**

Table 6: CRR Cost Summary

7. Commercial Systems (COMS)

The Commercial Systems (COMS) project provides business processes and systems for Settlements and Billing, Data Aggregation, Metering, Load Profiling, Credit Monitoring, Registration, Disputes and Financial Transfer. COMS is meant to deliver the following:

- Requirements for TPTF approval
- Settlement payments and charges for Day Ahead, RUC, Real Time, Ancillary Services, and CRRs
- Credit monitoring and management capabilities
- Invoicing capabilities
- Registration capabilities
- Disputes capabilities
- Financial Transfer capabilities

The Nodal Program estimated cost of COMS is $14.78MM as follows:

COMS	$
Internal Resource Costs	$5,561,400
External Resource Costs	5,112,200
Vendor Labor	3,905,235
Hardware, Software, misc.	$200,000
Total	**$14,778,835**

Table 7: COMS Cost Summary

8. Enterprise Integration (EIP)

The Enterprise Integration (EIP) project provides the technical integration/infrastructure for the program. EIP is meant to deliver an interface approach, common interface architecture and interfaces for the program.

The Nodal Program estimated cost of EIP is $12.32MM as follows:

EIP	**$**
Internal Resource Costs	$2,917,200
External Resource Costs	7,799,200
Vendor Labor	-
Hardware, Software, misc.	1,607,460
Total	**$12,323,860**

Table 8: EIP Cost Summary

9. Enterprise Data Warehouse (EDW)

The Enterprise Data Warehouse (EDW) project provides the capability to collect historic data and provide information services to Market Participants, PUCT, WEMM and FERC, perform data analysis. EDW is meant to deliver the following:

- EDW strategy and roadmap
- EDW Governance structure
- Requirements for TPTF approval
- Business Intelligence – dynamic reporting (CDW framework)
- Business Intelligence – standard reporting (including internal, MOMS, Market, Compliance, Credit reporting)
- Operational Data Stores (including Lodestar, EMMS ODS)
- Market data extracts
- Information replication (ODS, RSS replication)

The Nodal Program estimated cost of EDW is $4.04MM as follows:

EDW	**$**
Internal Resource Costs	$2,492,800
External Resource Costs	1,544,000
Vendor Labor	-
Hardware, Software, misc.	-
Total	**$4,036,800**

Table 9: EDW Cost Summary

10. Infrastructure (INF)

The Infrastructure (INF) project involves the development, testing, EDS and production environments across the Program. INF is meant to deliver the following:

- Hardware specifications
- Hardware procurement
- Data center capacity resolution
- IT Services Catalogue
- Service Level Agreements for all Nodal projects
- Project development & test (FAT) environments
- Integration testing (ITEST) environments

- EDS environments
- Production environments

The Nodal Program estimated cost of INF is $61.84MM as follows:

INF	$
Internal Resource Costs	$2,191,800
External Resource Costs	5,547,520
Vendor Labor	1,759,300
Hardware, Software, misc.	52,341,787
Total	**$61,840,407**

Table 10: INF Cost Summary

11. Integration Testing (INT)

The Integration Testing (INT) project consists of ERCOT functional, integration and user acceptance testing for the program. INT is meant to deliver the following:

- Ensuring the Quality Center is available to COMS/NMMS/MMS/EMS for functional testing and for training COMS/NMMS/MMS/EMS on its use
- Developing Smoke and Regression suites from the test scripts delivered by COMS/NMMS/MMS/EMS
- All functional testing for CRR/EDW/MIS projects
- INT is responsible for integration testing
- INT is responsible for integration performance testing

The Nodal Program estimated cost of INT is $16.98MM as follows:

INT	$
Internal Resource Costs	$4,691,272
External Resource Costs	11,349,461
Vendor Labor	-
Hardware, Software, misc.	936,650
Total	**$16,977,383**

Table 11: INT Cost Summary

12. Market Participant Engagement & Readiness (MER)

The Market Participant Engagement & Readiness (MER) project involves the Market Participant approval of Nodal designs, preparation for and participation in testing and trials, and training and readiness of live Nodal operations. MER is meant to deliver the following:

- Training design (to accommodate several learning styles) development & delivery, and web-based training
- Communications
- TML replacement with new MIS web portal
- Market Participant Readiness Criteria, status reporting & Declarations
- Customer Care

The Nodal Program estimated cost of MER is $21.54MM. as follows:

MER	$
Internal Resource Costs	$4,503,850
External Resource Costs	11,394,780
Vendor Labor	4,377,209
Hardware, Software, misc.	1,268,039
Total	**$21,543,878**

Table 12: MER Cost Summary

13. ERCOT Readiness & Transition (IRT)

The ERCOT (internal) Readiness & Transition (IRT) project involves the preparation of the ERCOT organization and final verification of all parties' readiness to operate under the Nodal Protocols in live operations. IRT is meant to deliver the following:

- Early Delivery System (EDS) strategy and plans
- ERCOT Readiness Criteria
- ERCOT Readiness & Transition Plans (by function)
- ERCOT readiness preparations
- EDS Market Trials
- ERCOT Readiness Declarations

The Nodal Program estimated cost of IRT is $29.28MM as follows:

IRT	$
Internal Resource Costs	$13,133,224
External Resource Costs	16,146,615
Vendor Labor	-
Hardware, Software, misc.	-
Total	**$29,279,839**

Table 13: IRT Cost Summary

From: M. Petterson
To: Finance & Audit Committee
Date: December 5, 2006
Re: Accounting for the Independent Market Monitor

Objective

1. Summarize the accounting practices that will be used to capture and report the costs of supporting the Independent Market Monitor (IMM).

Practices

1. ***Direct operational charges*** – Costs incurred by ERCOT in direct support of IMM staff as they carry out their duties will be coded directly to one or more, uniquely identifiable "activity" codes within ERCOT's accounting system. At present, it is expected that most direct operational costs will be represented by vendor invoices, from service providers such as Potomac Economics, and ERCOT staff time invested to support requests of IMM staff.
2. ***Direct project charges*** – Project costs incurred to create or modify hardware and software systems required by IMM staff or facilities costs to provide adequate office space or network connectivity will also be coded directly to one or more, uniquely identifiable "activity" codes within ERCOT's accounting system.
3. ***Indirect charges*** – There will be no accounting transactions posted to allocate to IMM activities indirect or overhead charges, such as facilities costs, information technology assistance, and procurement and contracting support. Since the costs of supporting the IMM are recovered through the ERCOT System Administration Fee, the time, effort, and complication of formally preparing and posting cost allocation transactions is not essential; however, financial management reports will include an estimate of indirect charges to provide information as to the total cost of supporting the IMM. Indirect facilities costs and will be estimated based on actual historical costs to operate and maintain ERCOT facilities and the square footage of office space used by the IMM. Other overheads and support services including human resources, legal, payroll, and procurement and contracting support will be estimated based on average actual historical support costs relative to total ERCOT spending.
4. ***Management reporting*** – Commencing in January 2007, the monthly financial summary report prepared for management, members of the Finance and Audit Committee, and the ERCOT Board of Directors will include a summary of direct operational charges, direct project charges, and estimated indirect charges incurred by ERCOT to support the work of the IMM.

From: M. Petterson
To: Finance & Audit Committee
Date: December 5, 2006
Re: Accounting for the Texas Reliability Entity

Objective

1. Summarize the accounting practices that will be used to capture and report the costs of supporting the Texas Reliability Entity (TRE).

Practices

1. ***Direct operational charges*** – Costs incurred by or for ERCOT employees assigned to TRE responsibilities will be coded to a newly created TRE department and one or more, uniquely identifiable "activity" codes within ERCOT's accounting system. Other costs incurred in direct support of staff assigned to the TRE will be coded directly to the same department and "activity" codes within ERCOT's accounting system.
2. ***Direct project charges*** – Project costs incurred to create or modify hardware and software systems required by TRE staff or facilities costs to provide adequate office space or network connectivity will also be coded directly to one or more, uniquely identifiable codes within ERCOT's accounting system.
3. ***Indirect charges*** – Since the costs of the TRE are separately budgeted, are recovered through a discrete fee subject to scrutiny and approval by federal agencies, and are subject to audit by outside parties, the formal preparation and posting of cost allocation transactions is essential Accounting transactions will be posted to allocate to the TRE indirect or overhead charges, such as facilities costs and support services including information technology assistance, human resources, legal, payroll, and procurement and contracting support. The facilities allocation will be based on actual historical costs to operate and maintain ERCOT facilities and the square footage of office space used by the TRE. The support services allocation will be based on average actual historical support costs relative to total ERCOT spending.
4. ***Management reporting*** – Commencing in January 2007, the monthly financial summary report prepared for management, members of the Finance and Audit Committee, and the ERCOT Board of Directors will include a summary of direct operational charges, direct project charges, and allocated indirect charges posted to the TRE.

Review SAS 70 Action Plan
Jim Brenton

- Project plan established to track SAS70 remediation and preparation. Status of tasks as of 12/1/06:
  - 56 complete
  - 10 in progress
  - 36 not started
- All activities will complete end of December 2006
- Process improvement (long-term) activities will complete March 2007
- Management response provided to PwC for final report on 11/30/06

Review SAS 70 Action Plan
Jim Brenton

Exception	Current Status
17.2 Lack of formal database hardening process or documentation.	• ***Database hardening requirements formally approved on 11/28/06*** • ***Gap assessment of existing databases to requirements being performed – will complete end of December '06***
17.4 Lack of documentation for access requests and approvals for the management of service and /or generic accounts.	• ***Automated tool developed and implemented on 11/30/06*** • ***Tool provides tracking and documentation of requests and approvals***
17.7 Lack of formal authorization for the use of "powerful utilities."	• ***Powerful Utility & Malicious Software Requirement document updated and formally approved on 11/30/06*** • ***Formal authorization process established***
17.8 Three terminated employees were found to have residual level access.	• ***Weekly compliance monitoring of terminated employees established on 11/17/06*** • ***All terminated accounts identified and removed***

- Control activities will be rewritten to be more concise and reflective of key controls
- External SAS70 subject matter expert (SAS70 SME) started on 12/4/06
- SAS70 SME will provide a 2007 SAS70 pre-audit

	ERCOT Finance & Audit Committee 2006 End of Year Self-Evaluation	Yes	No	Not Sure	Comments
1.	Does the committee have the appropriate number of members? The committee should not be so large that: ▪ its ability to operate efficiently and effectively is reduced ▪ members' ability to raise issues is hampered ▪ it is difficult to get a quorum when a time-sensitive issue arises	5			
2.	Committee members demonstrate their objectivity during meetings through behaviors such as driving agendas, rigorous probing of issues, consulting with other parties, and hiring experts, as necessary.	5			
3.	Differences of opinion on issues are resolved to the satisfaction of the committee.	4		1	On most issues; however, certain issues cause subjective behavior. Except for resistance to consider experts on credit. Usually. Credit issues still divide the committee.
4.	Committee members challenge the Chair as appropriate.	5			Definitely! But he still makes us start too early!
5.	The committee charter is used as a document to guide the committee in its efforts, and to help guide the committee's agenda.	2	1	2	Not really. Charter is revised to reflect our work.
6.	6.1 Committee members are financially literate, and the committee has determined that it has adequate financial expertise in accordance with its charter.	4		1	Generally yes, but uncertain of definition for "financial literate." Most members have a financial background; good mix.
	6.2 Committee members participate in some form of continuing education to stay abreast of changes in the financial accounting and reporting, regulatory and ethics areas.	1	3	1	I must take 40 hours per year. No training that is specifically financial or auditing. FAS 71

	ERCOT Finance & Audit Committee 2006 End of Year Self-Evaluation	Yes	No	Not Sure	Comments
	6.3 The committee understands how the organization's performance compares with its budgetary targets and its peers, and how management plans to address any unfavorable variances.	4		1	A strength.
	6.4 The committee discusses the initial selection of or changes in significant accounting policies used in developing the financial statements, the reason for and impact of any changes in policy, and reasons alternative treatments were not adopted.	4	1		Exhaustively, which is appropriate.
	6.5 The committee discusses significant, complex, or unusual transactions with management and the external auditors.	5			Routinely do so with appropriate rigor.
	6.6 The committee understands which areas represent high risk for material misstatement of the financial statements, and discusses assumptions and approaches used with management and the external auditors.	5			A lot of growth in understanding this over the past 2-3 years.
	6.7 The committee forms its own view of the risk of material misstatement due to fraud, discusses with management and the external auditors their views on the risk of material misstatement due to fraud, and is comfortable that any differences in views can be reconciled.	4	1		None that I can remember.
	6.8 The committee fully understands significant changes in financial statements from prior years and from budget, and is provided with sufficient, reliable evidence to support variances.	5			
	6.9 The committee commits sufficient time to review, discuss, and consider the financial statements.	3		2	Annual OK, but not certain about quarterly/ monthly
	6.10 The committee meets with financial management to discuss results reported before finalization.	4		1	
7.	Committee members have a clear understanding of ERCOT's debt structure and cash management practices.	3		2	
8.	Committee members receive sufficient details regarding long-term financial planning.	3	1	1	

	ERCOT Finance & Audit Committee 2006 End of Year Self-Evaluation	Yes	No	Not Sure	Comments
9.	The Committee makes appropriate use of workgroups or task forces to investigate issues defined by the Committee.	3	1	1	Concerns with the Credit Working Group. Credit Workgroup is an example. None that I know about.
10.	The committee engages outside experts as appropriate.	5			We interact with corporate auditors. Could use expert on credit.
11.	11.1 The organization's financial reporting processes are stronger as a result of management's interactions with the committee.	4		1	Absolutely
	11.2 The committee understands and agrees with the board on which categories of internal control it oversees. Categories include: ▪ Integrity of financial reporting ▪ Compliance with laws and regulations ▪ Operational efficiency and effectiveness	4			Board and committee are on the same governance page.
	11.3 The committee and the board concur with any changes to the committee's internal control oversight mandate.	4		1	
	11.4 The committee understands the current high-risk areas - including information technology and computer systems - in the categories of controls it oversees, as well as how management addresses those areas.	4		1	
12.	The committee is cognizant of the line between oversight and management, and endeavors to respect that line.	4		1	Not always. High level of Board scrutiny on legal problems.
13.	The committee conducts executive sessions in a manner that offers a "safe haven" to the individual, while at the same time asking tough and necessary questions, evaluating the answers, and pursuing issues that might arise to a satisfactory resolution.	3	1	1	Generally this is not the purpose of executive session. Executive sessions are very candid and appropriate.

	ERCOT Finance & Audit Committee 2006 End of Year Self-Evaluation	Yes	No	Not Sure	Comments
14.	14.1 The committee does its part to ensure the objectivity of the internal audit team.	5			Strength.
	14.2 The committee provides constructive feedback to the chief audit executive at least annually.	4		1	
	14.3 The committee receives sufficient detail regarding material issues and complaints brought forward which relate to the company's fraud, ethics or accounting practices.	5			EthicsPoint is reviewed constantly. EthicsPoint works.
	14.4 The committee has developed the scope of work to be done by the independent auditor and by the internal audit department based upon a reasoned review of the risks or exposures to the company.	5			Committee and staff do this together. Have a risk adjusted 2007 audit plan
15.	The committee communicates at an appropriate level of detail when informing the Board of its actions.	4		1	Ask the Board. I hope so?
16.	Committee members receive clear and succinct agendas and supporting written material sufficiently prior to scheduled meetings.	5			Clear – yes. Succinct – no.
17.	Committee members have adequate opportunities to discuss issues and ask questions.	3		2	Usually, except for credit. May be time limited.
18.	The frequency of committee meetings is appropriate for the responsibilities assigned to the committee.	2		3	Committee may meet too often. Generally yes, but we are often pushed for time. See below.
19.	Meeting facilities and presentation materials are effective for the conduct of committee activities.	5			

	ERCOT Finance & Audit Committee 2006 End of Year Self-Evaluation	Yes	No	Not Sure	Comments
20.	Please add additional comments, questions and suggestions here.				F&A agenda is extensive and difficult to cover in 21/2 hours before BOD meeting, which still require 7:30 a.m. start. Consider alternating F&A agenda items that can be reviewed bi-monthly to reduce load. This would allow more thorough review of items to be reviewed. Charter should require independent director as chair.

2007 Yearly Planner – DRAFT*

January 23
February 20
March 20
April 17
May 15
June19
July17
August 21
September 18
September 4**
October 16
November 13
December 11

subject to Board adoption of its annual calendar

****special meeting to review proposed 2008 operating budget***

ELECTRIC RELIABILITY COUNCIL OF TEXAS, INC.
RISK MANAGEMENT EVENT PROFILE MATRIX (as of December 1st, 2006)

Strategic Position	Operational Excellence	Market Facilitation	Grid Reliability	Reporting	Compliance
Strategy Development *Objective setting adequately incorporates informed stakeholder input, market realities and management expertise*	**Performance Monitoring** *Clearly defined performance metrics linked to mission and goals; actively monitored, status communicated and corrective action taken*	**Customer Choice** *Market design promotes efficient choice by customers of energy providers with effective mechanisms to change incumbent market participants as desired.*	**Grid Operations** *Information required to operate the grid is efficiently gathered and appropriate tools are prudently configured to efficiently operate the system*	**Review Practices** ↓ *Prudent measures are taken to insure that company disclosures are properly vetted and not misleading*	**Legal & Legislative** *Operations are conducted in compliance with all laws and regulations and current and proposed legislation is understood and communicated*
ERCOT is in the process of incorporating Nodal planning into its short and long-range strategic plans. Turnover in mid and senior management has resulted in uncertainty regarding ERCOT's strategic vision	Management has rolled out a revision of the Executive Dashboard and have instituted regular Quarterly Business Reviews to discuss key business activities.	IT components supporting Customer Choice are currently not at the desired levels to meet SLA's. Successful replacement of SeeBeyond Application with TIBCO will have a major impact on Customer Choice operations.	Current tools utilized by the System Operator (including the State Estimator and the accuracy/availability of SCADA data) and the lack of an Operator Training Simulator exposes ERCOT to greater reliability risks.	Board of Director's review of management activities on an ongoing basis assists in ensuring proper review and disclosure practices.	Increased efforts have been made to inform members of the legislature about ERCOT and the performance of its functions.
Mission and Goals *Corporate objectives and performance standards are understood and followed*	**Business Practices** *Business planning, processes and management standards are effective and efficient*	**Nodal Implementation** *Nodal Implementation is progressing in a timely fashion on budget and schedule within a defined scope.*	**Planning** *Long-range planning methods enable efficient responses to necessary system changes to maintain reliability standards*	**Disclosure** ↓ *Reporting and other disclosures to intended parties is timely, accurate and effective*	**Internal Control Compliance** *Internal Control Compliance, processes and management standards are effective and efficient*
Current management initiatives related to goal setting and the development of Key Performance Indicators (KPI's) have increased awareness of organizational goals and related to high-level corporate objectives and priorities for individual divisions, departments, and employees.	Disaster recovery plans, record retention procedures, and safety practices are currently below desired expectations. Additional development activities required to implement and test these procedures.	Significant risks exist with respect to project budgeting, human resource staffing, project scope and management, and tracking completion of the project in an acceptable timeframe . The magnitude and scope of the initiative provides heightened levels of risk to the organization which have not been fully addressed. Recent management changes are also significant risks.	Lack of timely and accurate information necessary to build reasonable system models and forecasts, an insufficient ability to conduct long-range (6-10 years out) planning, and demands on planning resulting from a transition to Nodal. Long range planning issues must accurately address increased load growth forecasts as well as review adequacy of current spinning reserve requirements.	A Disclosure Committee has been institutionalized to discuss and report issues related to external reporting and compliance.	Audit findings are actively monitored by management as well as Internal Audit. Additional training activities are required to ensure all staff members are aware of ongoing internal control compliance processes and procedures.
Reputation *Positive perceptions by stakeholders typically lead to less cost and greater flexibility resulting in enhanced enterprise value*	**Human Resources** *Organization design, managerial and technical skills, bench strength and reward systems are aligned with corporate goals*	**Counterparty Credit** *Bankruptcies and other capital deficiencies increase the cost for market participants and potentially impact Grid reliability through participant failure*	**Bulk System Resources** *Market Participants have constructed and made available adequate bulk electric grid resources*	**Communication** *Internal and external communications are timely and effective*	**Industry Standards** *Business practices provide stakeholders with required assurances of quality*
High visibility of initial Nodal implementation impact ERCOT reputation as could increased scrutiny on ERCOT activities occuring during the bi-annual state legislative session.	While ERCOT has reduced the number of open positions, a large number of openings continues to be a focus of attention. The current compensation structure is outdated and is in the process of being revised. Turnover in key areas such as system operations presents additional concern.	Processes for removing defaulting participants from the market increases the potential for credit losses. A medium to large market participant default could materially impact the ERCOT market, grid reliability, and ERCOT's reputation. Recent PRR's related to shortening the timeframe related to drops to POLR have reduced exposure by an estimated 37%.	Uncertainty surrounding generation projects, installed and operational capacity, and the high dependency on natural gas in Texas' generation fleet may impact reliability. The risk exists for a hotter than normal summer or cooler winter to increase load demand to a level that reduces reserve margins below acceptable minimum levels.	Since the grid operation events of the spring, ERCOT has implemented several corrective measures. Meetings have been conducted with most of the members of the Texas Legislature who have jurisdictional responsibility over ERCOT, a crisis management project for communications has been completed and ERCOT is in the process of restructuring it's legal and communications departments.	Failure to adhere to ERCOT adopted industry standards, and/or industry standards with which ERCOT is expected to adopt, may increase risks. Changes in NERC / FERC standards and policies require ERCOT action to ensure ongoing compliance. SAS 70 Audit Issues and qualifications remain to be addressed with remediation activities underway to address findings in 1 area of 18 tested.
Fiscal Management *ISO design requires competent, prudent and cost effective provision of services*	**Technology Infrastructure** *Information systems and data are effectively managed and are reliable*	**Administration, Settlement & Billing** *Market rules are fairly applied to all participants and accounting is timely and accurately reflects electricity production and delivery*	**Operational Responsibility** *Market participants conduct their operations in a manner which facilitates consistent grid reliability*	**Adequacy and Integrity** *Robust processes exist to support management assertions embodied within financial reports*	**Regulatory Filings** *Evidence, testimony and other supporting materials are compelling and successful*
Current fiscal practices are effective in managing and controlling costs. Issues surrounding Nodal implementation budgeting and staffing allocation have not been fully addressed.	System development, testing, implementation, and data management environments are not at desired levels. Senior management turnover and continuing systems disruptions (Retail Systems, IT, EMMS) continue to be an issue of ongoing concern.	ERCOT's settlement/dispute processes has a significant number of ADR's related to the RPRS policy debate outstanding, however these are being addressed in a timely fashion.	Response of generators to past grid operation events requires greater scrutiny in analyzing market participant operations. Enhanced enforcement of NERC standards will exist through the ERO / RE structure.	Financial and Operations management information has been redesigned to enable management to effectively monitor and manage the business.	Filings are completed timely and accurately.

Legend: ↑ **Elevated Risk Level** ↓ **Reduced Risk Level** **(New Risk Categories / Descriptions Indicated in Green)**

Rationale for Category Risk Assessment Changes

Review Practices	**Upgrade - Green-Yellow to Green**	**Recent compliance efforts and audit reports indicate sufficent controls are in place regarding review practices**
Disclosure	**Upgrade - Green-Yellow to Green**	**A full review of disclosure activities has not discovered any issues and sufficient controls are in place to monitor activities**

2006 Year to Date Project Activity by Division

(January to November)

	Phase	Not Started	Initiation	Planning	Execution	Closing *	Completed *	Cancelled**	On Hold	Totals by CART
CART	Corporate Operations	0	0	3	7	8	3	0	0	21
	IT Operations	1	0	4	4	2	9	4	0	24
	Market Operations	3	0	3	12	3	10	6	2	39
	System Operations	4	3	7	10	1	13	2	3	43
	Totals by Phase	8	3	17	33	14	35	12	5	127

*NOTE: 6 projects went live in the month of November
**NOTE: 3 projects were cancelled before starting and one project cancelled in Execution.

Year to Date Project Priority List (PPL) Status

PPL Iterations	Origination	Project Phases						Subtotal	Grand Total
		Not Started	Initiation	Planning	Execution	Closing/Completed	On Hold/Cancelled		
Original 2006 PPL									31
	PUCT	1			2	2	3	8	
	Market			1	3	2	1	7	
	ERCOT			1	3	6	3	13	
	System Maintenance			1	1	1		3	
Unexpected Carry Over From 2005									18
	PUCT						1	1	
	Market					4	1	5	
	ERCOT			2		8		10	
	System Maintenance				1	1		2	
New Projects Added in 2006									78
	PUCT				1	2	3	6	
	Market	1		1	5		2	9	
	ERCOT	5		7	16	19	3	50	
	Compliance		3	1				4	
	System Maintenance	1		3	1	4		9	
2006 PPL totals as of November 1, 2006									127
	PUCT	1	0	0	3	4	7	15	
	Market	1	0	2	8	6	4	21	
	ERCOT	5	0	10	19	33	6	73	
	Compliance	0	3	2	2	2	0	9	
	System Maintenance	1	0	3	1	4	0	9	
Totals by Project Phase		8	3	17	33	49	17	127	

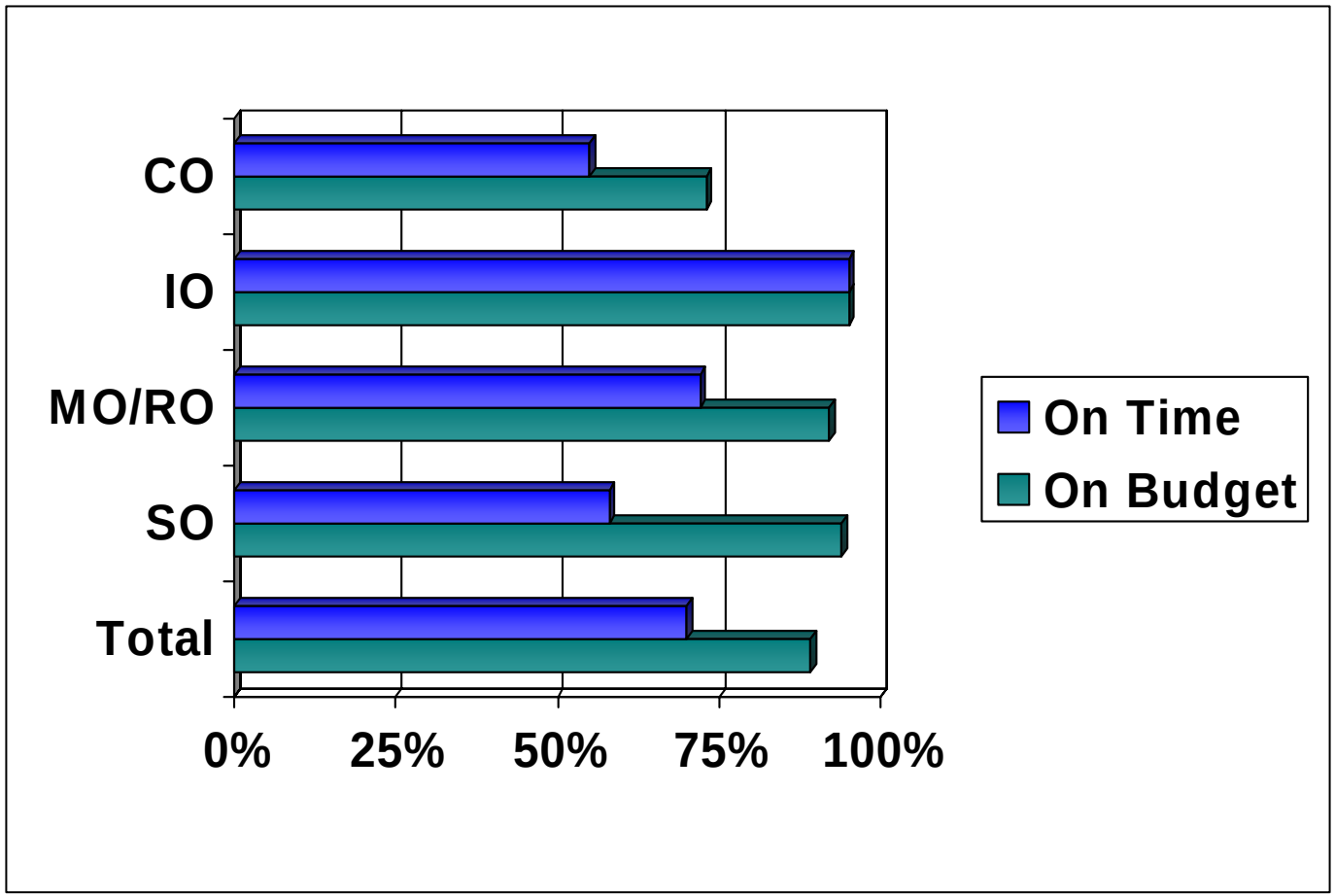
Committee Brief - PMO
David Troxtell

Projects Over $1M	Total Budget	Committed Actuals 11/30/06	Metrics	
Duration/Information (Sponsor)	**Phase/Scheduled Completion**		**Schedule**	**Budget**
Service Oriented Architecture (2004-2006)	**$8.3M**	**$7.39M**		
9 separate projects over 24 mos. (R. Giuliani)	*Execution Phase/4th Qtr 2006*			
Enterprise Data Warehouse (2003-2006)	**$3.5M**	**$2.85M**		
9 separate projects over 36+ mos. (R. Hinsley/R. Giuliani)	*Execution Phase/3rd Qtr 2006*			
Operator Training Simulator (2005-2006)	**$3.8M**	**$2.28M**		
Training Simulator System for Operators (S. Jones)	*Execution Phase/2nd Qtr 2007*			
Enhancements to FasTrak Tools (2005-2006) **New Target implementation date of 4th Qtr 2006. Green metrics reflect re-baselined schedule.*	**$2.5M**	**$2.52M***		
Tool for Tracking Market Issues (R. Giuliani)	*Execution Phase/4th Qtr 2006*			
Enhancements to SCR727 (2005-2006)	**$1.9M**	**$1.06M**		
Entered into Execution (R. Giuliani)	*Execution Phase/3rd Qtr 2006*			
Austin QA Build out (2005-2006) *Green Metrics reflect re-baselined schedule*	**$1.162M**	**$1.08M**		
Entered into Testing (R. Hinsley)	*Execution Phase/3rd Qtr 2006*			
Enhancements to MOMS Study Market Clearing Engines (2006)	**$1.2M**	**$854K**		
Entered Execution (S. Jones)	*Execution Phase/1st Qtr 2007*			
SBC Network Replacement (2005-2006)	**$1.47M**	**$1.46M**		
Fiber Build Out from Taylor to Austin (R. Hinsley)	*Execution Phase/4th Qtr 2006*			

ERCOT

2006 Year to Date Completed and Active Projects Performance

(January to November)



Go Live Projects for November

- **PR-40042_06 EDW Lodestar Batch Extracts**

  - **Scope**:. Establishment of methodology that will serve as the standard for developing and supporting data extracts for the Market Participants. Completion of this project will enable the transition of current Data Archive LodeStar batch extracts to the ODS, as well as development of enhanced reporting functionality for the Energy Analysis & Aggregation, Settlement, and Retail & Wholesale Client Services groups.

  - **Deliverables**: Methodology and framework for a functional/operational data store. Migration of first 5 Lodestar Extracts from Data Archive to the ODS (Generation, Load, Settlements & Billing, Shadow Pricing, and Settlement Input Data Extract)

  - **Timeline**: June 2004 – November 2006

Go Live Projects for November

- **PR-50007 Enhancements to FasTrak Tool**
  - **Scope**: The objective of this effort is to develop a solution that will replace or enhance the current FasTrak tool.
  - **Deliverables**: The project delivered an improved/created reporting functionality; improved/created tracking/metrics functionality; usable issue status'; usable issue types and sub types; a method to allow users to interface the solution; improved/created search functionality; improved/created monitoring and response capabilities; improved usability; and all functionality that is deemed required with the legacy tool remained as part of the enhanced solution.
  - **Timeline**: January 2005 – November 2006

Go Live Projects for November

- **PR-50078 SBC Network Replacement**

  - **Scope**: Replace SBC telecommunications infrastructure between Austin and Taylor that enables ERCOT to implement a private network comprised of AT&T and Alpheus fiber and Cisco equipment. ERCOT will lease fiber from AT&T between Taylor and Austin in addition to leasing fiber from Alpheus between downtown Austin and Met Center.

  - **Deliverables**: The project delivered a new installation of fiber from Spice point to Taylor, the leasing of existing Alpheus Fiber, an Interconnect agreement between AT&T & Alpheus, installation and testing of fiber connections from point to point (Taylor and Austin), and the installation of Cisco equipment at Taylor and Austin.

  - **Timeline**: August 2005 – November 2006

Go Live Projects for November

- **PR-60004_01 EIS Foundations**
  - **Scope**: This project was to establish the resources to support a Conformed Data Warehouse (CDW) in the EIS environment and is in direct support of Protocols Section 17, which is a required element to directly support Market Participants and the PUCT.
  - **Deliverables**: IT Infrastructure Equipment to support the PUCT requirements for EIS functionality. As required, this project installed CPU, Memory, I/O cards and Shareplex to support the EIS database growth.
  - **Timeline**: April 2006 – November 2006

Go Live Projects for November

- **PR-60076_01 Proxy Server**
  - **Scope**: Design, acquire and implement a web browser proxy system.
  - **Deliverables**: Install a commercial web browser proxy system onto the ERCOT network.
  - **Timeline**: January 2006 – November 2006

Go Live Projects for November

- **PR-60088_01 Market Management System Expansion**
  - **Scope**: The RTB markets have 4 minutes to complete their market clearing. They are often exceeding this timeframe. In order to address this hardware upgrades are required. HP Alpha server upgrades are not available after December 2006, and this expansion will upgrade the existing systems to capacity such that they can support operations until the Nodal project is complete.
  - **Deliverables**: Install Hardware upgrades, including CPU, memory, and I/O on the hardware located at the Taylor site and the Austin site.
  - **Timeline**: August 2006 – November 2006

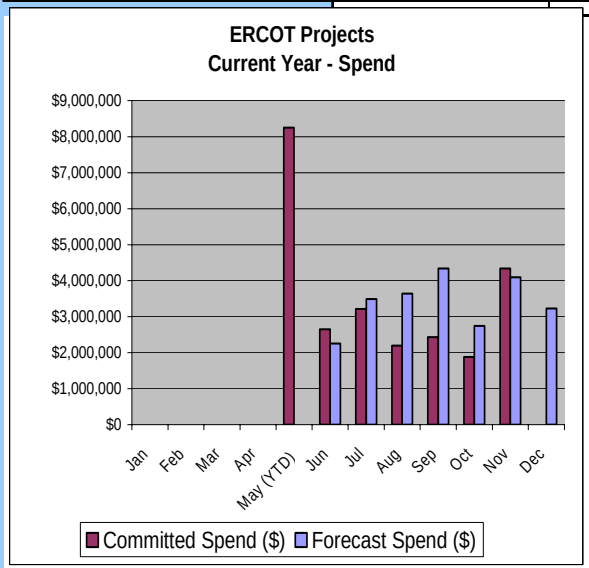
Enterprise Projects Summary Report

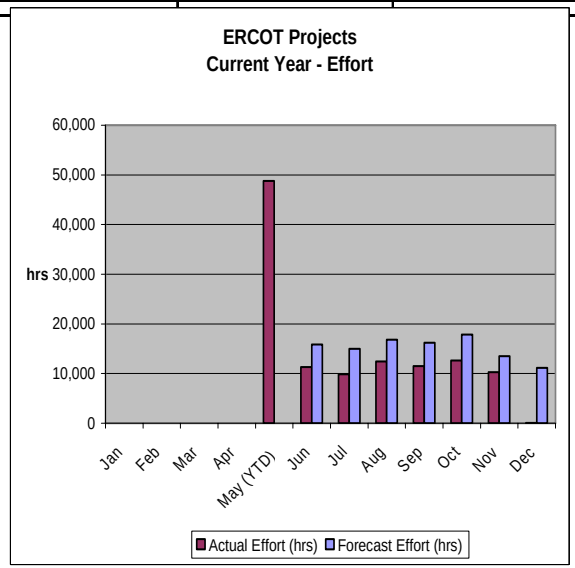
ERCOT Overall Projects Report — **Reporting Period: 11/30/2006** — **YTD**

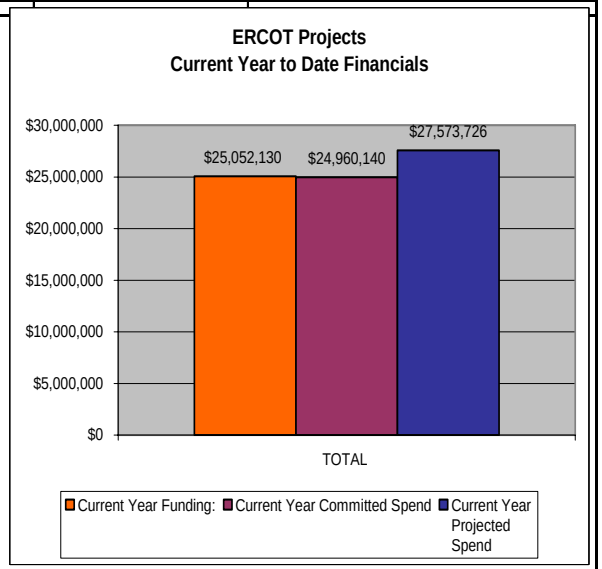
Summary

ERCOT Projects Leadership			Projects in ERCOT's Portfolio					Portfolio Performance			
Executives			Not Started	Initiation	Planning	Execution	Closing	Schedule	Budget	Risk	Milestones
Sam Jones	Ray Giuliani		8	3	17	33	14	Y	Y	Y	
Ron Hinsley	Steve Byone		Completed	35		On Hold	5				
			Cancelled	12		Total Projects	127	Prior Year Funding:		Current Year Funding:	$25,052,130

Portfolio Performance Summary







ERCOT Market Credit Status

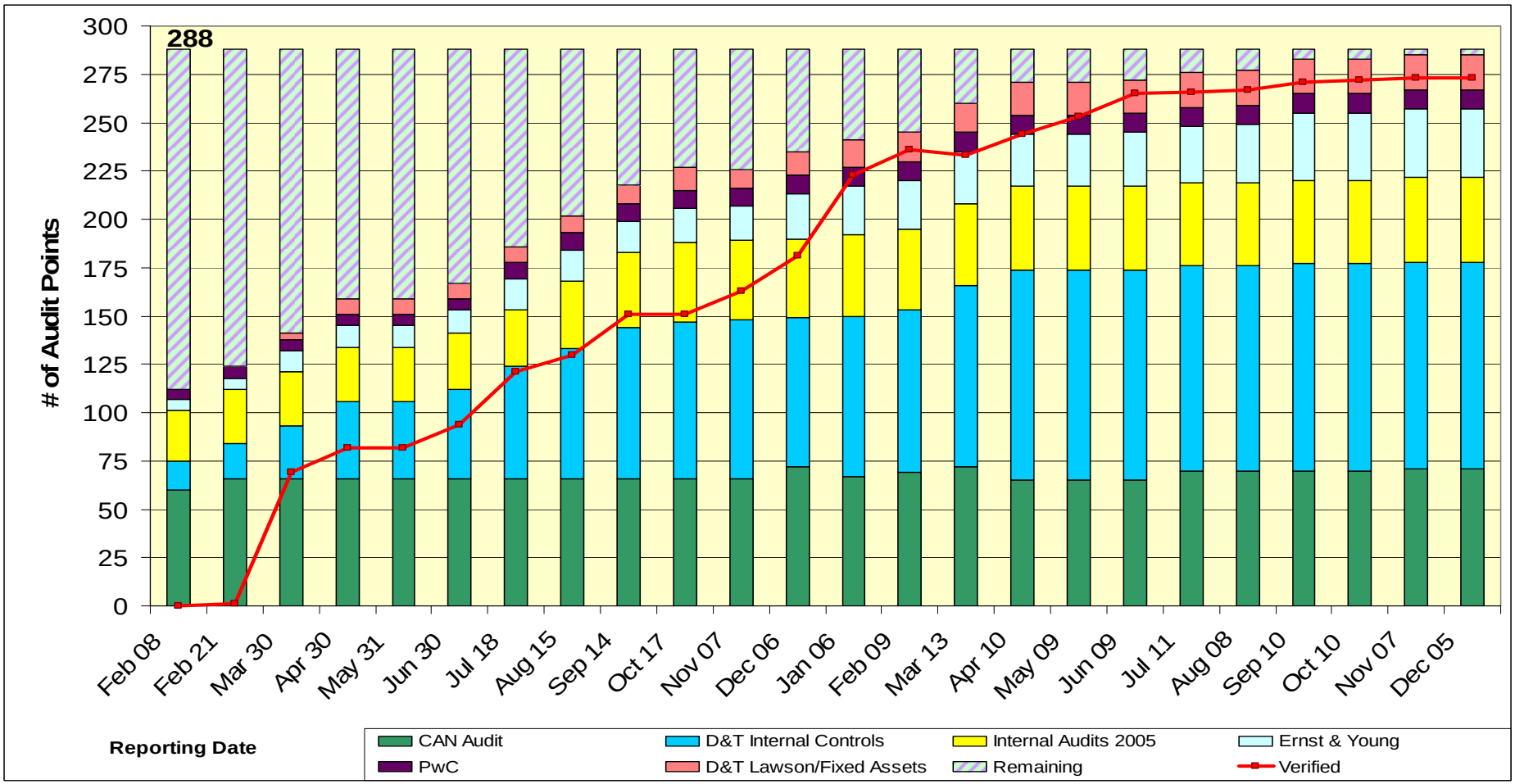
	as of 10/31/2006					as of 11/30/2006				
	# of QSEs*	Estimated Aggregate Liability ($)	% of EAL	Total Unsec Credit Limit / Security Posted		# of QSEs*	Estimated Aggregate Liability ($)	% of EAL	Total Unsec Credit Limit / Security Posted	
Exposure in the ERCOT Market (owed to ERCOT)										
QSEs that meet ERCOT Creditworthiness Standards										
Ratings over BBB-	6	25,199,490	9%	74,000,000	U	6	23,342,060	10%	67,000,000	U
QSEs that do not meet ERCOT Creditworthiness Standards										
Ratings below BBB- or not rated										
Cash & Letters of Credit	42	136,192,553	51%	290,675,293	S	47	99,003,647	41%	237,232,604	S
Guarantee Agreements	12	103,941,521	39%	364,367,000	S	14	121,943,135	50%	384,367,000	S
Total Exposure	**60**	**265,333,564**	**100%**			**67**	**244,288,842**	**100%**		
Other QSEs in the ERCOT Market (ERCOT owes)										
QSEs that meet ERCOT Creditworthiness Standards										
Ratings over BBB-	11	(5,934,476)	-13%	70,026,345	U	11	(3,902,285)	-15%	77,026,345	U
QSEs that do not meet ERCOT Creditworthiness Standards										
Ratings below BBB- or not rated										
Cash & Letters of Credit	41	(14,913,039)	-33%	31,148,605	S	38	(9,795,686)	-36%	21,180,386	S
Guarantee Agreements	13	(24,967,361)	-54%	139,400,000	S	10	(13,083,286)	-49%	116,900,000	S
Total	**65**	**(45,814,876)**	**-100%**			**59**	**(26,781,257)**	**-100%**		
Total	***125***					***126***				

U: Unsecured since these QSEs meet the creditworthiness standards
S: Secured i.e. required to post collateral since these QSEs do not meet the creditworthiness standards

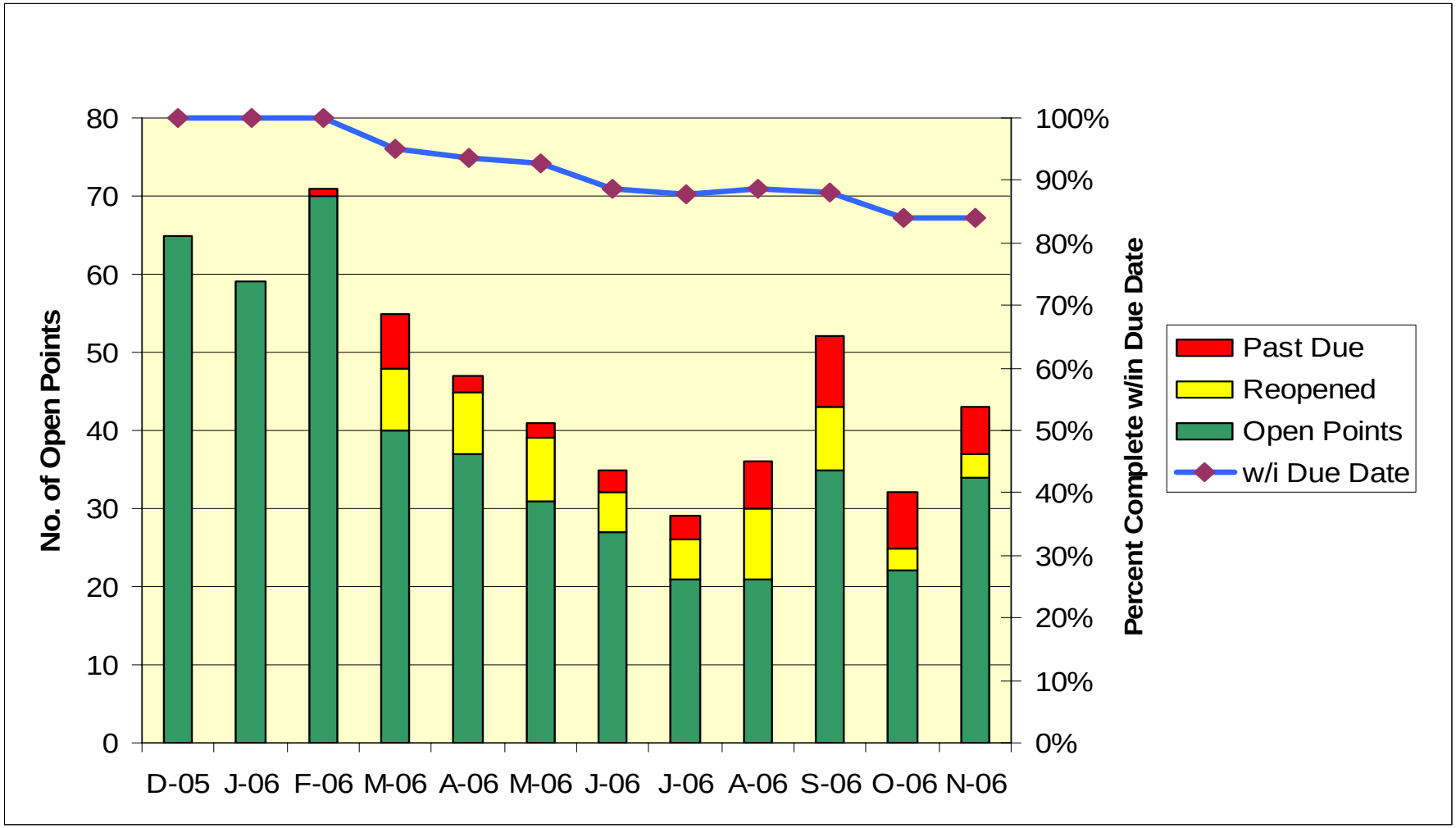
- **Deloitte & Touche completed review and testing of internal controls and provided a draft management letter**
- **ERCOT prepared a management response to include in the final management letter**
- **Design of the control framework for all processes with documented controls passed**
- **Testing of control activities resulted in a success rate over 95% (138 out of 145 controls were deemed effective)**
- **Appropriate controls were in place for all processes, but some were not properly executed**
- **Remediation activities for the control activities that did not pass during testing were developed and have been completed**

Completion Status by Audit
2004-05 Audit Points

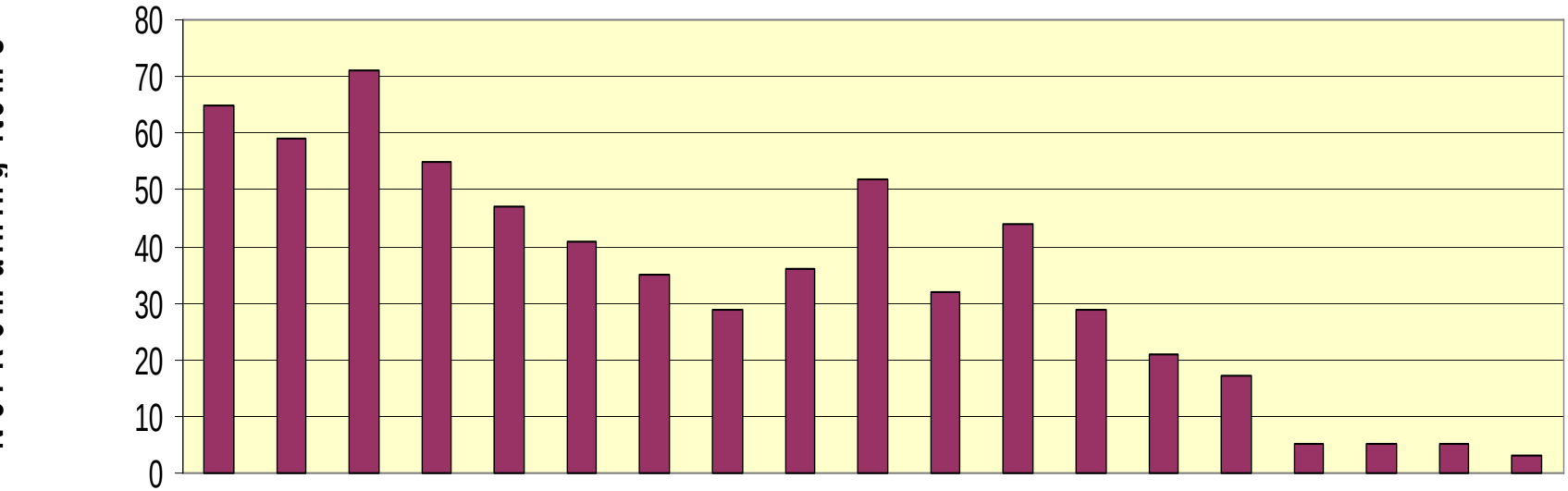
3 to complete



Status of Open Audit Points - 2006



Projected Audit Point Progress



	Dec-05	Jan-06	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07
Audit Points	65	59	71	55	47	41	35	29	36	52	32	44	29	21	17	5	5	5	3

Audits Completed (last 3 months)

Internal Audits

- QSE Credit Process
- Onboarding & Exiting of Employees & Contractors
- Cash & Investments
- Software License Mgmt
- Selected Nodal Employee & Contractor Expenses
- Fraud Prevention Program (Q!-Q2 Results)
- Fixed Assets
- Cyber Security (follow-up)
- System Operations (Compliance w/assistance from Internal Audit)
- Ethics Compliance

- External Audits
- 401K/MPP (PwC)
- Texas Nodal Program Review (IBM-managed by IAD)

Open Audits

Internal Audits

- Corporate Communications
- Procurement & Contract Administration
- Business Continuity Plan
- Budget Process
- Fraud Prevention (ongoing)

External Audits

- 2006 SAS70 (PwC)
- Internal Controls (D&T)
- 2006 Financial Audit (PwC)

Planned Audits (next 3 months)

Internal Audits

- SCADA
- MarkeTrak/Serena Team
- *Initiate 2007 planned audits*

External Audits

- Texas Nodal Program Controls Progress Reporting Review (IBM-managed by IAD)

- NOTE: Internal Audits performed by IAD, unless otherwise noted.

Consultation/ Analysis Reports Completed
(last 3 months)

External Assessments
- 1 security assessment completed in October

Open Consultation/ Analysis Reviews

External Assessments
- 3 security assessments currently underway to complete by the end of December

Planned Consultation/ Analysis Reviews
(next 3 months)

External Assessments
- 1 security review planned

Future Agenda Items – January 2007

- Elect committee officers and confirm financial qualifications
- Review Finance and Audit Committee charter
- Review guidelines for engagement of external auditor for Other Services
- Review PwC disclosure of auditor independence
- Assessment of compliance, the internal control environment and systems of internal controls
- Review preliminary 2006 financial results
- Review 2007 Finance department key goals
- Committee Briefs

F&A Yearly Schedule

Quarter 1

√ •Elect officers and confirm financial qualifications
√ •Review Finance Audit Committee charter
√ •Approve the Guidelines for Engagements of External auditors for Other Services (pre-approval policy)
√ •Required written communication and discussion of auditor independence
√ •Review scope of annual financial audit
√ •Report by CWG Chair on ERCOT credit policy
•Vote on CWG Chair

Quarter 2

√ •Report results of annual independent audit to the Board
√ •Report of external auditor pre-approval status/limits
√ •Review the procedures for handling reporting violations
√ •Review conflict of interest and ethics policies
√ •Review results of annual audit (including required communications)
√ •Review and approve ERCOT Annual Report
√ •Review operating plan and budget assumptions

Quarter 3

√ •Appoint the independent auditors for upcoming year
√ •Approval of independent auditor fees for upcoming year
•Assessment of compliance, the internal control environment and systems of internal controls
√ •Review and approval of annual operating budget
√ •Report by CWG Chair on ERCOT credit policy
√ •Review updated year-end forecast

Quarter 4

•Approve audit committee meeting planner for the upcoming year, confirm mutual expectations with management and the auditors
√ •Review and approval of Financial & Investment policies
√ •Approve scope of internal auditing plan for upcoming year
•Assessment of the adequacy and effectiveness of the Internal Audit staff
•Perform Finance & Audit committee Self Assessment
•Review requirements for membership in CWG
•Review and approve CWG charter
√ •Review updated year-end forecast

Recurring Items

•Review minutes of previous meeting
•Report monthly matters to the Board (chair)
•Review EthicsPoint activity
•Review significant audit findings and status relative to annual audit plan

√ Items completed for 2006

ERCOT