

MINUTES OF THE ERCOT FINANCE & AUDIT COMMITTEE MEETING

Austin Airport Hilton Hotel

9:00 A.M.

December 12, 2006

Pursuant to notice duly given, the meeting of the Electric Reliability Council of Texas, Inc. Finance & Audit Committee convened at 9:10 A.M. on **December 12, 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	Not 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:

Arterberry, Emma	ERCOT
Brenton, Jim	ERCOT
Byone, Steve	ERCOT (CFO)
Campbell, Cassandra	ERCOT
Delenela, Ann	ERCOT
Doolin, Estrellita	ERCOT
Fehrenbach, Nick	City of Dallas
Jones, Sam	ERCOT (CEO)
Kolodziej, Eddie	Customized Energy Solutions
Meek, Don	ERCOT
Moseley, Cheryl	ERCOT
Myers, Michelle	ERCOT
Petterson, Mike	ERCOT
Troxtehl, David	ERCOT
Vance, Cathy	ERCOT
Vincent, Susan	ERCOT
Wilkerson, Dan	BTU
Wullenjohn, William	ERCOT
Yager, Cheryl	ERCOT

Executive Session

At 9:11 AM, the Committee meeting was adjourned and the Committee went into Executive Session until approximately 9:25 AM. The Committee returned to Open Session at 9:30 AM.

Approval of Previous Minutes

William Taylor moved to approve the minutes for the previous meeting held on November 14, 2006; Scott Gahn seconded the motion. The motion passed unanimously.

PwC Non-Audit Services

Michael Petterson informed the Committee of certain minor non-audit services ERCOT would continue to obtain from its independent financial auditor, PriceWaterhouseCoopers—namely, a renewed subscription to PwC's comprehensive, web-based accounting database. Petterson submitted a memo to the Committee dated December 5, 2006, which is attached hereto as **Exhibit A**, to provide the Committee written notice of the transaction. Clifton Karnei noted that the Charter notice requirement to disclose such non-audit services was an outgrowth of "Enron-type irregularities" where some audit firms were receiving greater revenues from their non-audit services than their audit services. Mr. Petterson confirmed that the total amount to be paid for the PwC database for 2007 was approximately \$2,000.

Materiality Principles

Michael Petterson reminded the Committee of prior discussions regarding materiality of transactions, explaining that staff was looking for a definitive statement regarding materiality in the context of the annual external financial statement audit, to help staff to determine the appropriate level of resources to devote to internal controls. Mr. Petterson reviewed the key elements taken from a memo dated December 5, 2006 regarding ERCOT Financial Materiality, which is attached hereto as **Exhibit B**. Mr. Petterson confirmed that the \$350,000 amount which would be considered "material", as noted on page 2 of the memo, equated to five percent of ERCOT operating expenses. Mr. Petterson also pointed out that, as previously discussed by the Committee, in circumstances involving fraud, intentional conduct, or if accounting treatment caused a net deficit to become a net benefit, even smaller amounts would be considered to be material. Steve Byone confirmed to the Committee that Sean Barry of PwC was in support of the materiality approach outlined in the memo. Mike Petterson reiterated Bill Wullenjohn's comments made at an earlier Finance and Audit Committee meeting that the materiality thresholds outlined in the memo would not be binding to Internal Audit and that Mr. Wullenjohn's staff would continue to investigate even smaller transactions if circumstances warranted. Mr. Byone informed the Committee that staff was not looking for a vote, but was seeking Committee endorsement of this framework. The Committee reviewed, discussed and concurred with the concepts outlined in the memo, but agreed that the document would be a "living" document and could be revised in the future, as required.

Credit Workshop Proposed Agenda

Cheryl Yager presented the proposed agenda for a Credit Workshop, which is attached hereto as **Exhibit C**, for the Committee's approval. The Committee discussed the purposes of the workshop, ERCOT's role in credit decisions and responsibilities for credit failures, and the details of the proposed agenda. The Committee expressed its desire that all Board members be invited and encouraged to attend the workshop. Mr. Karnei requested that the workshop include a discussion by Legal of the legal ramifications of ERCOT's role in credit decisions. Scott Gahn requested that the workshop provide for a broad discussion of the responsibilities and accountabilities for credit risk and failures, and that staff present an example of the ramifications of a large REP failure. Mr. Gahn also requested that any acceptance by the market of credit risk should be documented so that ERCOT staff would not be held accountable for this choice. Ms. Yager noted that even if best practices were implemented, there was no

way to fully eliminate all credit risk. William Taylor requested that the workshop include a discussion regarding the governance of the Credit Work Group, including information regarding how other ISOs and similar groups handled credit risk. Steve Byone suggested inviting PUC staff to discuss their role as it relates to overall financial stability of the ERCOT market. The Committee requested the following: (1) all Committee and other Board members be invited and encourage to attend the workshop; (2) include the requested presentation by a representative from the ERCOT Legal Department; (3) move the item "Review current level of credit exposure" to the top of the agenda; (4) send an email to confirm the proposed time of 11AM to 4PM on the day before the January 2007 Board meeting. Clifton Karnei commended the preparers of the draft agenda for organizing a nebulous topic in a cohesive manner.

Accounting Highlights

Michael Petterson presented three memos dated December 5, 2006 titled Accounting for the Texas Nodal Market Implementation Program (TNMIP), Accounting from the Independent Market Monitor (IMM), and Accounting for the Texas Regional Entity (TRE), which memos are attached hereto as **Exhibits D, E & F**, respectively. William Taylor encouraged staff to immediately inform the Committee if it became clear that current resources were inadequate to complete the intricate accounting and tasks set forth in the memos.

- **TNMIP.** Steve Byone explained that one purpose of the memo regarding TNMIP accounting was to inform the Committee of how certain estimates were determined and how certain cost allocations would be administered.
- **IMM.** Petterson reminded the Committee that all costs related to the IMM would be covered by the system administration fee and that no separate fee would be collected. Steve Byone added that while IMM costs would be embedded in normal ERCOT accounting records, certain reports were being developed in anticipation of questions from the PUC. Dan Wilkerson requested that the relationship between the IMM financial officer and the ERCOT CFO be clarified in the proposed Bylaws draft that was being circulated and discussed at TAC.
- **TRE.** Sam Jones confirmed that FERC would require an audit of the TRE financial statements by an independent auditing firm. Mr. Byone explained that this audit would be separate from the financial statement audit of the ERCOT financial statements, but could be performed by the same independent auditing firm. Bill Wullenjohn informed the Committee that Internal Audit had scheduled an audit of the TRE financials scheduled for the second quarter of 2007.

SAS 70 – Action Plan

Jim Brenton presented an update on the SAS 70 Remediation Action Plan for the 2006 audit exceptions. Mr. Brenton noted that PwC had done a good job of digging deep during the audit, and that he concurred with PwC that ERCOT needed better documentation and more formalized review and approvals. Mr. Brenton noted that certain "fast fix" items had been presented to and accepted by PwC for inclusion in the November 30, 2006 report; all medium term items would be completed by December 31, 2006; and long-term items would be completed by February or March 2007. Mr. Brenton informed the Committee that an outside SAS 70 subject matter expert had been engaged to assist staff with implementation and review of certain items in the Action Plan and that the external resource would also help ensure that staff was appropriately following all processes. Mr. Brenton noted that the biggest challenge going forward was implementation of the new database hardening guidelines, because it was

critical to apply hardening guidelines without disrupting day-to-day operations. Mr. Brenton confirmed that the remediation must be carefully planned and implemented to avoid adverse impact on the availability of production systems. Mr. Brenton also confirmed that none of the issues noted in the SAS 70 report had impacted the integrity of the ERCOT systems or data. Mr. Karnei asked and Bill Wullenjohn confirmed that Internal Audit would review remediation of all areas prior to the follow-up audit by PwC.

Finance & Audit Committee Self-Assessment Results

The Committee discussed results of the 2006 self-assessment and noted the irony of the fact that comments indicated that some members suggested that the Committee should meet less often and others suggested that the Committee was pressed for time to adequately discuss all issues. The Committee suggested that the members ask the Board to consider whether the Committee should be separated into a Finance & Budget Committee and an Audit Committee, and the Committee should consider potentially scheduling certain standing agenda items only every other month. The Committee also discussed the potentially negative optics of having only one of five Unaffiliated Directors on the Committee, and Mr. Karnei asked whether they should select an Unaffiliated Director as Chair for 2007. The Committee determined that it should discuss the issues regarding potential separation of the Committee and increased Unaffiliated Directors on the Committee with the full Board during the 2007 retreat.

Preliminary 2007 Meeting Planner


Steve Byone presented the preliminary 2007 meeting planner which is based on the tentative Board annual calendar and included one additional meeting date (September 4, 2007) to review the proposed 2008 operating budget.

Committee Briefs

- Enterprise Risk Management. Steve Byone noted that there had been only two changes to the Risk Management Event Profile Matrix ("Stop Light Report")—namely, reduced risk level for Review Practices and Disclosure.
- PMO. Steve Byone explained that total year capital project efforts were expected to be slightly ahead of budget and that more information would be presented during the meeting of the full Board.

Adjournment

At 10:42 A.M., the meeting was adjourned. The next Committee meeting will be held in January 2007.



Susan Vincent, Secretary