

BS&P Guidelines for NYISO Budget Preparation/ Financing and for Project Monitoring

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Executive Summary

An effective project budgeting and financing process is essential to ensure sound investment decisions that result in reliable, efficient and cost effective operations over the long term. Such processes also aid in assuring that the NYISO remains a viable, cost-effective ISO. This paper sets forth guidelines for the Market Participants and NYISO Staff to use in establishing the NYISO Operating and Capital Budgets and in monitoring project costs.

These guidelines are designed to allow Market Participants and NYISO Staff to continue to carry out their responsibilities in a collaborative way and are not intended to change the respective responsibilities of the NYISO Board and Management Committee as set forth in the NYISO Agreement. Article 7 section 7.02(e) states that the Management Committee shall have the responsibility of “Preparation of the ISO capital and operating budgets for review and approval by the ISO Board.” Article 5 Section 5.08 states that “The ISO Board also shall be responsible for the financial affairs of the corporation, including the ISO’s capital and operating budgets.” These guidelines suggest a process for use in the preparation of a five-year Budget Target and an Annual Operating and Capital Budget recommendation for review and approval by the NYISO Board.¹

The budget process is comprised of four stages which are described below:

1. Budget Preparation
2. Identification and Selection of Projects
3. Project Monitoring

¹ Throughout this document, the term “Budget Target” refers to the five-year (long term) budget. The term “Annual Budget” refers to the first year of the Budget Target.

4. Evaluation

The budget process is neither intended nor designed to manage staffing, or the ongoing operations or business management of the NYISO or to supplant the Board's financial responsibility for NYISO operations, nor its autonomy and independence . Similarly, the budget process is neither intended nor designed to supplant the responsibilities of the Management Committee provided for in the Independent System Operator Agreement..

1 Budget Preparation

A necessary step in the budget preparation process is to refer to the NYISO's Strategic Plan. The evolution of the Annual Budget, Budget Target and Strategic Plan will be an iterative process. Using the Strategic Plan as a reference, staff will prepare a preliminary Annual Budget and Budget Target and will provide Market Participants with the information upon which the preliminary budgets are based. This will assist Market Participants in their review and comment on the preliminary budgets and assist them in preparing a budget recommendation of the Annual Budget to the ISO Board. Among other things, the Budget Target would clearly identify those funds that would be treated as an expense and those funds that would be available from longer term financing. It is recognized that the budgeting process needs to be flexible with respect to the out years to accommodate new and changing missions in future years.

2 Identification and Selection of Projects

Project requests will likely originate from a number of different sources for a variety of reasons including: NYISO identified market or operations enhancements or corrections of market flaws; FERC orders; Committee, Subcommittee and Working Group actions; PSC initiatives; resolution of Seams Issues; and, Market Participant requests.

Projects, other than NYISO required “in-year projects” which are fully described below, will generally be presented first to either the Business Issues Committee (BIC) or the Operating Committee (OC) for consideration and approval. In certain cases, project requests may be directly presented to the Management Committee (MC). The NYISO Staff will provide costs estimates and potential budget impacts along with other information associated with proposed projects that come before the Management Committee. Projects estimated to cost \$500,000 or more will require MC approval prior to being forwarded to the Project Priority Team (PPT) for advice on prioritization and scheduling. The PPT shall take into account, inter alia, the budget impacts when determining prioritization and scheduling.

Some projects may not be anticipated for inclusion in the annual budget, but are developed during the year for implementation within that budget year (“in-year projects.”) Generally such projects will go through the Committee review process outlined above. However, a NYISO proposed in-year project that may be completed within the year and within the Annual Budget without significantly impacting the implementation of other approved projects or the Budget Target do not require MC approval. MC approval will also not be required in the event that the NYISO determines

that the reliability of the system may be in jeopardy and/or that the existing market design does not result in a competitive and efficient outcome. Such projects, undertaken by the NYISO, will be reported at the next scheduled BS&P meeting and will be included in project monitoring reports.

3 Project Monitoring

The NYISO staff shall prepare periodic status reports that provide information on project schedules, milestones and man-hour expenditures for all projects for the PPT and the BS&P Subcommittees. At the next scheduled BSP meeting, NYISO staff shall inform the BS&P if a project has exceeded or is expected to exceed its cost estimates by the lesser of 50% of the project's costs or \$500,000. NYISO Staff shall also inform the BS&P when a project is expected to adversely impact the current operating budget or future year budgets in a manner that is not already incorporated into the budget process.

The BS&P or its Chair or Vice Chair shall have an automatic right to add a report and action item to the agenda for the next scheduled MC meeting upon a request placed with the Chair of the Management Committee five business days prior to the date of the Management Committee meeting.

4 Evaluation

If a project can be linked to specific goals or objectives, the NYISO Staff will provide the BS&P with information necessary for the BS&P to evaluate whether a project has achieved those goals and objectives. The overall effectiveness of the budgeting process associated with each project will be reviewed by the NYISO Staff and the BS&P

and lessons learned will be used to modify the budgeting process and selection decisions for future projects considered by the MC.

Section 1.0 Annual Budget and Budget Targets

Commencing with the establishment of the 2004 Annual Budget, the annual budget process will produce a Budget Target, developed by NYISO Staff in consultation with the BS&P Committee. Consistent with current practice, the Annual Budget is voted on² by the Management Committee for recommendation to the ISO Board, and reviewed and approved by the NYISO Board. The Budget Target will include NYISO operations and capital projects for a five-year period with the first year being the Annual Budget. The budget process described in this document for the purposes of evaluating Major Projects and capital budgets will not be applied to routine operating expenses. The initial Budget Target (2004-2008) will be developed using the 2003 original approved budget as a base point. The first year included in the Budget Target will be quite detailed and provide, at a minimum, the same level of information as has been provided in recent³ one year budgeting processes. The remaining four years included in the Budget Target, by their nature, will be less precise and detailed. At a minimum, the NYISO Staff will provide, for each of those four years, an estimate of expenditures for ongoing operations as well as approved and anticipated projects, both expensed and capitalized. Initiatives such as new buildings, back-up control centers, hardware and software upgrades, etc. may also be included in the Budget Target.

Depending upon the nature, scope and resources required, the costs of some projects may be borne as an operating expense in the year incurred whereas the cost of other projects or initiatives may be funded through external capital financing with the related debt service obligations (principal and interest) being recovered over a period of

² "Voted on" as used herein means adoption of the 1st year of the Annual Budget.

³ Recent budgets such as the 2002 and 2003 operating budgets.

years. The Budget Target will separately identify that portion of the projects' and initiatives' costs which will be expensed and recovered through the Operating Budget and that portion which is to be capitalized.

1.1 Project Budget Summary Report

For those projects and initiatives, the costs of which are to be expensed, the NYISO will provide the following information, on an aggregated category basis, by year, for the five-year period of the Budget Target:

- The total amount of money estimated to be available for project expense funding.
- Estimated expenditures (costs) for those projects that are already underway.
- Estimated expenditures (costs) for those projects that have been prioritized and scheduled by the PPT but are not yet underway.
- Funding available for project expenses that have not yet been prioritized and scheduled.

For those project and initiatives the costs of which are to be funded through external capital financing, the NYISO will provide the following information, on an aggregated category basis, by year, for the five-year period of the Budget Target:

- The estimated capital budget (financing requirements).
- The total amount of money estimated to be available for the debt service payments of financed projects.
- The debt service payments for completed projects.
- The debt service payments for projects already underway.
- The estimated debt service payments associated with projects that have been prioritized and scheduled by the PPT but are not yet underway.
- The estimated funds (revenue) available for the payment of debt service for projects that have not yet been prioritized and scheduled.

For those projects and initiatives where certain costs may be expensed and the remaining portion of the costs capitalized, the same information as described above shall be included.

1.2 Project Budget Report

The Project Budget Report will be prepared and updated by the NYISO Staff as project prioritization and scheduling are recommended by the PPT. The Project Budget Report will report by project, the information that is aggregated in the project summary report. The report should be prepared monthly to contain the following:

- Project Budget Summary Report described above.
- A listing of completed financed projects grouped by year with the past and remaining future recovery.
- A listing of active projects showing the budgeted amounts, historic expenditures and projected expenditures along with a breakdown by expensed and financed portions of the project. For financed projects, the expected debt service obligation cost recovery by year.
- A listing of scheduled projects showing the budgeted amounts with a breakdown of expensed and financed portions. For financed projects, the expected cost recovery by year.
- A listing of approved but unscheduled projects with budgeted costs by quarter.

Section 2.0 Identification and Selection of Projects

As described in an earlier section of this document, projects will have different points of origin and require different levels of review and approval. In general though, a preliminary project proposal should include, at a minimum, the following information:

- Project Name
- Project Description, including perceived need
- Initial description of expected benefits
- Desired/required completion/on-line date

In addition to projects, initiatives such as new buildings, back-up control centers, hardware upgrades, etc. may involve significant expenditures. An initiative which meets the same criteria as a Major Project will also be included and monitored in the budget process. Major Projects are defined to encompass both projects and initiatives the total costs⁴ of which exceed \$500,000. While all projects of any size are accounted for in the NYISO budgets, only Major Projects are intended to be subject to these Budget Process guidelines and to Committee review procedures.

The NYISO Staff will develop initial cost estimates to determine whether a project or initiative will exceed the \$500,000 threshold and thus be forwarded to the Management Committee for a recommendation. NYISO Staff will endeavor to provide this threshold information prior to a BIC or OC vote. NYISO Staff intends to provide resource estimates prior to MC votes on these projects.

As a general practice, most Major Projects will pass the initial screening phase conducted by BIC, or the OC, before entering the Selection Phase of the process. The Selection Phase of the process will involve more detailed analysis of the Major Project.

⁴ Total costs include both the cost of outside consultants and other direct expenditures plus the cost of internal ISO resources such as labor costs.

Staff's analyses will be presented to the MC for its consideration. In certain cases there may be exceptions to BIC/OC initial screening process. Examples of exceptions include: those proposed projects submitted directly to the MC for consideration, instances where the NYISO Staff has already commenced its detailed analysis and the process noted in Section 2.4 below for NYISO required projects expected to be completed in-year without impacts on existing or future year budgets..

Table 1 sets forth the specific roles and responsibilities of the key participants in the Identification and Selection phase of this process.

Table 1. Identification and Selection Phase

Party	Roles & Responsibilities
Project Proponent/s and/or Working Group/Task Force	<ul style="list-style-type: none"> • Develop project proposal. • Submit proposal to BIC or OC. • Provide additional screening information if requested.
BIC or OC	<ul style="list-style-type: none"> • Review proposal. • Accept, modify or reject. • If adopted, forward project proposal to NYISO Staff for detailed analysis.
NYISO Staff	<ul style="list-style-type: none"> • Commence detailed analysis and prepare resource and cost estimates. • Present results of analysis to MC
Management Committee	<ul style="list-style-type: none"> • Adopt, modify or reject projects following lower committee action (if applicable). • Receive BS&P and PPT reports.
Project Priority Team	<ul style="list-style-type: none"> • Recommend a Prioritization of the projects adopted by the MC.
BS&P Review Committee	<ul style="list-style-type: none"> • Evaluate projects assigned for further analysis by the MC. • Prepare overall budget reports for MC review.

2.1 Screening Phase

The principal objective of the screening phase is to determine whether the proposal is viable and merits further detailed analysis by the NYISO Staff.

The project's proponents will submit the proposal to either BIC or the OC. The Committee conducting the review may use the following as screening criteria to assist in its determination of whether the proposal requires detailed analysis to be conducted by the NYISO Staff.

- Does the project align with the NYISO Strategic Plan?
- Is it needed for the performance of these functions?
- If feasible, can economic benefits be ascribed to the project?
- Does the project support operational, or work, processes that have been simplified or otherwise redesigned?
- Does the project improve service reliability?
- What are the expected benefits of the proposal?
- Is the project required by regulation?
- Are there major risks involved that will reduce the likelihood of the project performing as expected?
- How do the alternatives, if any have been developed, compare with the proposal?

Projects deemed qualified by either BIC or the OC will be submitted to the NYISO Staff for detailed analysis and preparation of further cost estimates.

2.2 NYISO Staff Detailed Analysis

If a Major Project is approved by the BIC or OC, the NYISO Staff in conjunction with the proponents, will conduct a detailed analysis of the proposal. As appropriate, the NYISO Staff's analysis will include:

- Project Name
- Project Description, including need.
- Alternatives, if developed, including potential benefits.

- Preliminary estimated stream of expected benefits (both quantitative and qualitative).
- Preliminary estimated stream of project costs (identify components separately – labor, hardware, software, consultants, etc.).
- Estimated timeline for project completion.
- Whether project can be accommodated within the Budget Target without impacting other already scheduled projects.
- Whether project qualifies for long term financing.
- Whether the project would require deferral of other already scheduled projects.
- Whether the project would require funding beyond that which is contained in the budget target.
- Associated risks of not implementing the proposed project.
- A recommendation as to whether the project should be approved by the MC.

The NYISO Staff will forward the results of its analysis to the MC for its consideration. Major Projects that are approved by the MC will be forwarded to the PPT for further recommendations as to scheduling and prioritization.⁵

2.3 In-year projects

While many projects will be approved for implementation beginning in future budget years, some projects may not have been included in the annual budget, but may be slated for development during the current budget year. Generally such in-year projects will go through the process described above. However, these projects will require additional evaluation by the NYISO Staff to determine whether the project can be fit within the currently approved annual budget without adversely affecting other projects. If in-year projects are adopted when there are insufficient funds budgeted to cover the costs of implementing the Major Project, several approaches may be used to address the funding shortfall including:

- Deferring implementation of the Major Project through the PPT.

⁵ All projects currently being worked on by the NYISO, regardless of origination, are reviewed by the PPT.

- Adjusting the timing and priority of other projects through the PPT
- Recommending that the NYISO Board approve an increase in Rate Schedule 1 charges to collect the necessary funds for the Major Project
- Recommending that the NYISO Board increase the level of financing available for Major Projects.

To the degree possible, the NYISO Staff, PPT and BS&P shall endeavor to inform the Market Participants of the impacts of such actions prior to the Management Committee action on the issue.

2.4 NYISO required Projects

Major Projects proposed by the NYISO that can be completed within the current budget year and within the currently approved budget without adversely affecting other projects or future year budgets do not require MP approval. Similarly, projects required by the NYISO as a result of its determination that the reliability of the system may be in jeopardy and/or that the existing market design does not result in a competitive and efficient outcome do not require MP approval. The BS&P will be informed of such projects at its next regularly scheduled meeting. These projects will also be included in the project monitoring reports and evaluation processes described below.

3 Section 3.0 Project Monitoring

The NYISO staff will monitor the status of all projects, regardless of their origin, and prepare periodic reports. Among other things, these monthly reports will identify each project's progress relative to: actual costs incurred versus approved budget, whether the project can be completed within budgeted cost and schedule. At least quarterly the NYISO will present a report on whether changes in project scope.

3.1 Establish and Maintain Project Cost, Schedule, and Scope

The NYISO Staff will provide periodic updates to PPT and BS&P on the status of the project's cost, schedule, and scope.

The NYISO staff shall prepare periodic status reports that provide information on project schedules, milestones and man-hour expenditures for all projects, regardless of origin, for the PPT and the BS&P Subcommittees. The NYISO will prepare quarterly reports on project scope. NYISO staff shall affirmatively inform the BS&P when any project exceeds or is expected to exceed its cost estimate by the lesser of 50% of the project's costs or \$500,000. NYISO Staff shall also inform the BS&P when a project is expected to adversely impact the current operating budget or future year budget targets in a manner that is not already incorporated into the budget process.

The BS&P Committee or its Chair or Vice Chair shall have an automatic right to add a report and action item to the agenda for the next scheduled MC meeting upon a request placed with the Chair of the Management Committee five business days prior the Management Committee meeting.

3.2 Assess Project Progress

Throughout a project's life, from pre-operational stages through completion, NYISO staff will assess progress against the project's budgeted cost, schedule, and Scope.

3.3 Project Monitoring Status Reports

The NYISO Staff shall provide Monitoring Status reports periodically for the PPT and BS&P. The contents of this report will be developed collaboratively.

Section 4.0 Evaluation

NYISO Staff will conduct an evaluation of Major Projects included in the Budget Preparation and Financing and Project Monitoring Process after the project becomes operational, usually within six months of deployment. The Evaluation Phase “closes the loop” of the budgeting process by comparing actual costs against budget. This will not only allow performance to be assessed, but also helps identify areas where decision-making can be improved. The evaluation should include:

- An evaluation of whether the project met scope, performance, cost and scheduling objectives; and
- An evaluation of whether the budgeting process improved the outcome of the investment.

The NYISO Staff shall share these evaluations with the PPT and BS&P to offer a better understanding of project performance and to allow BS&P to recommend to the NYISO Staff adjustments to the project or to the budgeting process, as it deems appropriate.

Such evaluations should take place immediately if a Major Project is cancelled.

The NYISO Staff shall also evaluate, and report to the BS&P, on a Major Project’s investment value or the impact of the project on reliability, economics, customer satisfaction and system capability.

This evaluation should focus on three primary areas described below.

1. Impact on Stakeholders

The project’s impact on stakeholders would be measured by the NYISO Staff through use of surveys (formal or informal), interviews, and feedback studies.

2. Ability to deliver performance measures (Quantitative and Qualitative)

The project's impact should be carefully evaluated to determine whether it met its original scope.

3. Ability to Meet Performance Goals

- Cost
- Benefit
- Schedule

NYISO staff shall discuss with the BS&P its conclusions, based on these evaluations, of lessons learned, including costs, project management and technical insights and shall work together with the PPT and BS&P to develop, recommend, and modify the budgeting process as appropriate.

Section 5.0 Transition

This guideline document outlines a desired end state. By necessity, the implementation of this business process will take time. It is expected that different aspects of this process will be implemented over a course of twelve months.⁶ Staff will evaluate resources necessary to perform these functions and advise the Market Participants if there are concerns about the resources required to implement the guideline or the design of this guideline. It is anticipated that this guideline may be revised several times as the process is developed and refined over the next few years.

⁶ Some evaluation elements may not be in place until 2005.