Internal Controls in the FERC & NERC World
Governance, Controls and Efficiencies: Tools for an Effective Compliance Program

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Presenters

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Views expressed in this presentation are our own and do not necessarily reflect or are intended to reflect the views of KCP&L.
Customer Overview
More than 825,000 customers

Service Territory

Stable Regulated Customer Base

Operating Statistics

Company Profile
17,934 square miles 425 substations
3,414 miles transmission 11 Counties in Kansas
36 Counties in Missouri

Transmission Miles

<table>
<thead>
<tr>
<th>KCPL SERVICE TERRITORY</th>
<th>KCPL-GMO SERVICE TERRITORY</th>
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<tbody>
<tr>
<td>4,600 square miles</td>
<td>13,334 square miles</td>
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<tr>
<td>1,719 miles transmission</td>
<td>1,695 miles transmission</td>
</tr>
<tr>
<td>190 substations</td>
<td>235 substations</td>
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<tr>
<td>14 Counties in Missouri</td>
<td>22 Counties in Missouri</td>
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<tr>
<td>11 Counties in Kansas</td>
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More than 6,600 MW of generating capacity with coal/nuclear base load in KCPL and with a coal base load in KCPL-GMO

Agenda

- Relating to our Industry - Effective Compliance Programs
- Understanding frameworks and potential impacts
- Identifying Internal Controls
- Exploring Examples
- Question and Answer

*Action expresses priorities - Ghandi*
What is an effective compliance program?

What kills a skunk is the publicity it gives itself. – Abraham Lincoln

FERC’s Effective Compliance Program

1. Internal standards and procedures to prevent and detect violations;
2. High-level management knowledge and oversight of internal compliance programs;
3. Reasonable (due diligence) efforts to screen out “poor performers”;
4. Reasonable internal communications and training efforts;
5. Reasonable steps to evaluate program effectiveness, including confidential reporting options for employees;
6. Creating and enforcing compliance incentives and noncompliance sanctions;
7. After detection of a violation, companies shall take reasonable, responsive steps.

Note: Appendix to September 17, 2010 FERC order on revised Civil Penalty Guidelines
NERC’s Internal Compliance Program

Four Hallmarks of effective compliance programs:

1. Senior management / leadership
   • Compliance Program established
   • Compliance Program is formally documented and widely disseminated
   • Compliance Program supervised by high ranking company employee
   • Supervisor has access to President / CEO and Board
   • Compliance Program is designed and managed with independence
   • Sufficient resources to implement compliance program
   • Full support of leadership
2. Preventive measures in place
   • Frequency of review of compliance program
   • Frequency of training of employees on compliance program
   • Sufficiency of training of employees on compliance program
3. Prompt detection, cessation, and self-reporting
   • Sustainable process to internally assess compliance with regulations
   • Sufficient response to identification of wrong-doing or misconduct
4. Effective remediation
   • Effective internal controls and procedures to prevent recurrence of misconduct

The “Practicality” Factor

What do you mean resources are limited?

• Executive and Organizational support is critical;
• Evaluate and understand the risk;
• Synergies or efficiencies between decentralized compliance functions are important;
• Utilizing established effective programs will assist maturation of less developed compliance programs:
• Understand your baseline – are we compliant currently?
• Correlate the different measurements (Sentencing Guidelines, Penalty Guidelines, etc) for efficiency of response;
• Efficiencies in administration and process automation is crucial where possible;
Understanding frameworks and potential impacts

*Fire prevention is much better than fire fighting.* – W. Edwards Demming
Aligning Internal Control and Compliance Activities

Board of Directors sets directional tone for company Delegate authority to those who have the expected ethics, values and competence

Identify high level individual(s) to oversee the organization’s compliance and ethics program

Regularly re-assess internal and external changes that may change the compliance and ethics risks

Identify operational, financial and compliance risks to prioritize compliance activities

Align changing risks and expectations with overall company strategy and operational structure

Set and manage reasonable standards for operational performance

Identify operational, financial and compliance risks to prioritize compliance activities

Regularly re-assess internal and external changes that may change the compliance and ethics risks

Align changing risks and expectations with overall company strategy and operational structure

Evaluate periodically the effectiveness and efficiency of compliance and ethics activities

Inform employees and others who need to know about the compliance and ethics expectations

Evaluate periodically employee understanding of key risk areas, laws and policies

Reward employees and others for understanding and compliance with laws and policy

Periodically validate compliance and ethics activities meet operational, financial and compliance needs

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Reward employees and others for understanding and compliance with laws and policy

Periodically validate compliance and ethics activities meet operational, financial and compliance needs

Provide adequate up-to-date reports and best practices to users or to assist guidance

Take corrective action for non-compliance and appropriately report findings

Identify high level individual(s) to oversee the organization’s compliance and ethics program

Reward employees and others for understanding and compliance with laws and policy

Periodically validate compliance and ethics activities meet operational, financial and compliance needs

Aligning Internal Control and Compliance Program Frameworks

NERC Internal Compliance Program

Self Review and Monitoring
Prevention, Remediation and Corrective Action
Leadership and Governance
Standards and Procedures
Prevention Measures
Senior Management Leadership

FERC Penalty Guidelines

Self Review and Monitoring
Prevention, Remediation and Corrective Action
Leadership and Governance
Standards and Procedures
Prevention Measures
Senior Management Leadership

US Sentencing Commission Guidelines

Auditing and Monitoring
Discipline

Training and Communications
Incentives

Prevention and Remediation

Standards and Procedures

Care in Delegation Leadership and Oversight

COSO Internal Control Framework

Care in Delegation Leadership and Oversight

Standards and Procedures

Leadership and Governance

Prevention Measures

Senior Management Leadership

Effective remediation

Prompt detection, Cessation and Self-reporting

Prevention Measures

Senior Management Leadership

COSO Internal Control Framework

Care in Delegation Leadership and Oversight

Standards and Procedures

Leadership and Governance

Prevention Measures

Senior Management Leadership

Effective remediation

Prompt detection, Cessation and Self-reporting

Prevention Measures

Senior Management Leadership
Identifying Internal Controls

The greater danger for most is not that our aim is too high and we miss it, but that it is too low and we hit it. – Michelangelo

Internal Controls

*Provide proactive, forward looking method to focus on reliability (NERC)*

*Provides proactive, forward looking assurances that the compliance action occurs (Company perspective)*

**Preventive or Detective**

Internal Controls are not requirements and are not enforceable, per se........
- Your companies are already performing internal controls,
- Don’t let terminology differences get in the way,
- Increase accountability for your subject matter experts and the partnership to achieve compliance.

*Proposed NERC definition: Internal controls are processes, procedures, tools, training and systems designed to help a registered entity ensure reliability, maintain accountability, and achieve compliance with NERC Reliability Standards. An entity’s internal controls provide auditors a level of assurance that the entity has a forward-looking compliance program. (Work in Progress)*
Exploring Examples

Do or do not. There is no try. – Yoda

Stop and Think About Controls
Baking Up Controls

Sorting out controls
KCP&L: Internal Controls example

KCP&L - CIP-001 Controls

Requirement 1: Each Reliability Coordinator, Balancing Authority, Transmission Operator, Generator Operator, and Load Serving Entity shall have procedures for the recognition of and for making its operating personnel aware of sabotage events on its facilities and multi-site sabotage affecting larger portions of the Interconnection.

Preventive Controls:
- Sabotage Awareness and Reporting Procedures
- Operating Instructions for Transmission and Power System Operators
- Training of personnel on sabotage awareness
- Communication materials (posted signs, etc)

Detective Controls:
- Monitoring of ES-ISAC information
- Detection of sabotage not reported

KCP&L: Internal Controls example

KCP&L - PER-001 Controls

Requirement 1: Each Transmission Operator and Balancing Authority shall be staffed with adequately trained operating personnel.

Preventive Controls:
- Job Descriptions and requirements
- Training Programs
- Operating Instructions for Transmission and Power System Operators
- NERC Certification exams
- Knowledgeable supervision
- Communication materials (posted signs, etc)
- Continuing education requirements

Detective Controls:
- After action reviews
- Incident numbers
- Performance Reviews
- Investigations
- Reported incidents – FERC Hotline
KCP&L Approach

Identification of requirements:

- First action was to identify the “library” of obligations for the company
  - Linkage to regulatory language to monitor regulatory environment;
  - Identification of internal compliance owner (role and name);
  - Frequency of occurrence;
  - Other information as necessary.

Response:

- Assess compliance requirements for existing processes, evidentiary materials, compliance owner expertise;
- Assign risk profile (based on predetermined factors);
- Work with business owner to close any identified gaps or strengthen position;
- Monitor based on internal risk assessment at appropriate frequency;
- Partner with compliance owner on changes to regulations for policy shaping or compliance actions;
- Identify efficiencies in compliance response or operational synergies with other compliance requirements.

KCP&L Approach continued

- Correlation of compliance obligations:
  - Linked through internal controls;
  - Designed test of controls or test steps to accommodate multiple requirements;
  - Consistency in evidentiary materials;
  - Efficiencies in compliance monitoring;
  - Efficiencies in compliance owner response time;
  - Consistency in legal approach and guidance;
  - Risk based approach to assignment of compliance resources.

*The best way to predict your future is to create it.* – *Abraham Lincoln*
**KCP&L: Internal Controls example**

*KCP&L – Standardization of Generator Interconnection Agreements and Procedures – Order No. 2003 (FERC) and FAC-001 (NERC)*

- The Transmission Provider shall acknowledge receipt of an interconnection request within five business days of receipt. The Transmission Provider should attach a copy of the interconnection request to the acknowledgement.

- Requirement 4: The Transmission Owner shall maintain and update its Facility connection requirements as required. The Transmission Owner shall make documentation of these requirements available to the users of the transmission system, the Regional Entity, and ERO on request (five business days).

**Preventive Controls:**
- Facility Connection Procedures
- Participation and adherence to Regional Transmission Organization Procedures
- Training of personnel on procedures
- OASIS posting of Connection Requirements validation
- Communication tracking and monitoring

**Detective Controls:**
- Annual Procedural Review
- Review of requirements within facility connection instructions
- Testing of notices received and tracked response time

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**Question and Answer**

I’d rather eat in a bar than drink at a restaurant.
It’s almost time for lunch

Finished product following proper processes and procedures with effective controls