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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Customer Overview
More than 825,000 customers

Service Territory

Stable Regulated Customer Base

More than 825,000 customers

Residences: 727,100
Commercial Firms: 96,400
Industrial and Other: 2,200
Operating Statistics

Company Profile

<table>
<thead>
<tr>
<th></th>
<th>KCPL Service Territory</th>
<th>KCPL-GMO Service Territory</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miles</td>
<td>17,354</td>
<td>15,154</td>
</tr>
<tr>
<td>Substations</td>
<td>425</td>
<td>405</td>
</tr>
<tr>
<td>Counties</td>
<td>36 Counties in Kansas</td>
<td>11 Counties in Kansas</td>
</tr>
</tbody>
</table>

Transmission Miles

- KCPL: 3,414 miles transmission
- KCPL-GMO: 1,719 miles transmission

- KCPL: 235 substations
- KCPL-GMO: 131 substations

- KCPL: 190 substations
- KCPL-GMO: 190 substations

- KCPL: 11 Counties in Kansas
- KCPL-GMO: 22 Counties in Missouri

Generation Mix

More than 6,600 MW of generating capacity with coal/nuclear base load in KCPL and with a coal base load in KCPL-GMO

- Coal: 83%
- Nuclear: 13%
- Natural Gas and Oil: 2%
- Wind: 2%

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 is supervised by high ranking company employee
   - 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
   - Sufficient 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 the directional tone for the 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
- Establish process for compliance and ethics responsibility and oversight throughout the corporation
- Periodically validate compliance and ethics activities meet operational, financial and compliance needs
- Inform employees and others who need to know about the compliance and ethics expectations
- Validate periodically employee understanding of key risk areas, laws and policies
- Reward employees and others for understanding and compliance with laws and policy
- Provide adequate options to report potential compliance and ethics issues or to seek guidance
- Take corrective action for non-compliance and appropriately report upstream

COSO Internal Control Framework

- Auditing and Monitoring
- Discipline
- Training and Communications
- Incentives
- Prevention and Remediation
- Standards and Procedures
- Care in Delegation
- Leadership and Oversight

US Sentencing Commission Guidelines

- Effective remediation
- Prompt detection, Cessation and Self reporting
- Preventive Measures

NERC Internal Compliance Program

- Self Review and Monitoring
- Training
- Prevention, Remediation and Corrective Action
- Standards and Procedures
- Leadership and Governance

FERC Penalty Guidelines

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 supervisors
- 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 ERC 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

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