

Evidence Standards and Insights for NERC Compliance Audits



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Presented by Russ Hissom and Carol Arneson

Baker Tilly Virchow Krause, LLP

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1

About Baker Tilly Virchow Krause



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Company Overview

- Firm established in 1931—a 75 year history of focusing on client needs and providing outstanding service
- 13th largest Public Accounting and Consulting Firm in USA (*Public Accounting Report's* "Top 100 2008")
- Over 170 partners and more than 1,400 professionals = Depth of Resources
- Seamless global services through Baker Tilly International (BTI)
- Industry Awards for Outstanding Service and Employee Satisfaction

Nationwide energy practice

- Nationwide energy practice with more than 300 utility clients across North America – our Energy and Utilities Group is focused *just* on utilities
- Proud supporter of Industry Associations



2

Baker Tilly Evidence Standards and Insights for NERC Compliance Audits Presenters



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Russell Hissom, CPA, Partner in the Energy and Utilities Group, specializes in serving the financial and operational needs of the utility industry. He has extensive experience with financial and compliance audits of utilities, work order asset management and FERC accounting implementation projects, construction audits, management audits, contract compliance audits under jointly owned electric generation contracts, overhead cost allocation studies, training for NERC Regional Organizations in how to conduct effective audits, NERC Audit Readiness projects for Registered Entities, and specialized accounting training for utilities. He has spoken nationally on a variety of utility topics for organizations such as APPA and NERC Regional Audit Organizations.



Carol Arneson, PMP, MBA, Senior Manager in the Energy and Utilities Group, has worked in the utility industry since 1976 specializing in financial and operational needs. She has broad utility experience at two Fortune 500 utility companies where she managed financial, cost management, strategy and business planning, generation support processes, and various other business processes for over 20 years. Carol has managed numerous projects serving municipal and investor-owned utilities including contract compliance audits, energy management services contracting and performance audits.



3

Evidence Standards and Insights for NERC Compliance Audits



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At the request of NERC Regional Organizations, Baker Tilly has spent the last two years teaching courses to their organizations and Registered Entities on general auditing and evidence gathering techniques used for NERC Compliance audits. We have presented this course to over 400 people from Regional Organizations and Registered Entities!



4

UPDATE 1-FERC oks \$25 M fine over Florida power blackout

WASHINGTON, Oct 8 (Reuters) - The U.S. power market regulator on Thursday approved a \$25 million settlement against Florida Power & Light Co over a February 2008 blackout that left millions of consumers in South Florida without power for several hours.

The settlement is the Federal Energy Regulatory Commission's first civil penalty under its new electric reliability standards and its first joint enforcement effort with the North American Electric Reliability Corporation, the FERC-designated Electric Reliability Organization that oversees daily enforcement of the reliability standards.

<http://www.reuters.com/article/marketsNews/idUSN0852535120091008>

3. We require that NERC and Regional Entities “base their compliance audit processes in the U.S. on professional auditing standards recognized in the U.S., such as Generally Accepted Accounting Standards, Generally Accepted Government Auditing Standards, and standards sanctioned by the Institute of Internal Auditors.”

10. A compliance audit should ascertain that the registered entity is in compliance with a requirement or that there is evidence that a violation of the requirement has occurred. A compliance audit team should not consider or discuss whether a monetary penalty or some other sanction would be appropriate if the Regional Entity finds that the registered entity has violated the requirement. Nor should a compliance audit team base its decision regarding whether evidence of a violation exists upon the resources or time needed for litigation or settlement of a related notice of alleged violation.

Auditors should prepare and maintain audit documentation.

Independent Reviewer Test (aka MOTS)

Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor, who has had no previous connection with the audit, to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions.

Audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

Audit Documentation Standards

The form and content of audit documentation should be designed to meet the circumstances of the particular audit. The information contained in audit documentation constitutes the principal record of the work that the auditors have performed in accordance with standards and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment.

Motto for a Successful Audit



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You must think like an auditor and know what an auditor knows to be successful in this process



9

Audit Documentation and Evidence “Stacking Evidence”



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Quality of Audit Evidence – *View from the Reliability Organizations*

- Some evidence is better than others
 - Data can be gathered by management – auditor must determine if information is valid and reliable
 - Third parties can gather data – auditor must determine reliance on that data
 - Corroborate weaker evidence with more evidence to gain reasonable assurance – Evidence Stacking is Encouraged
 - ***The RO will not base evidence quality or other decisions in the audit upon a potential monetary penalty. They attempt to separate a “finding” from the enforcement implications.***

Records of Classes & Attendance

CIP Training Manual

Compliance Program Req – CIP Training



10

What are the five levels of organizational maturity?



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Ad Hoc - Knowledge is held with the individual, not shared broadly and differs from person to person



Basic - the organization begins talking and sharing however most information and knowledge still remains with the individual



Standardized - Common mind set, documentation is embraced



Managed- Understanding of best practice and implementation across the organization. Policies, procedures, rules, guidelines are developed and are applied in a consistent manner that yields results



Adaptive - Competitive value is achieved, learning flattens and knowledge begins to coalesce across the organization toward common and shared results

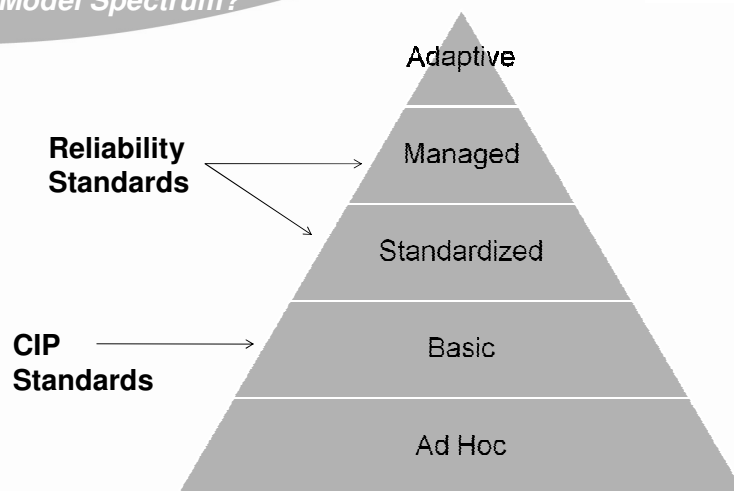


11

NERC Compliance Business Processes Where is Your Organization on the Organizational Maturity Model Spectrum?



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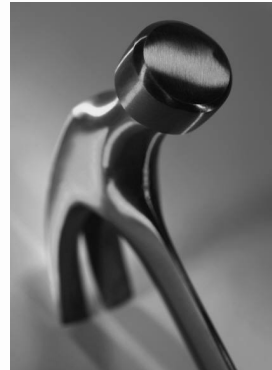
12

Utility Survey on NERC Audit Preparedness Selected Responses on Getting Ready



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1. Audit preparation activities
2. Who did the preparation in-house?
3. Use of consultants to prepare
4. Types of evidence evaluated
5. Evaluation of Overall NERC Compliance Program
6. Evidence evaluation methods by NERC audit team
7. Communication of results
8. Mitigation plans
9. Internal follow-up by the organization



13

Baker Tilly Observations on our NERC Audit Participation



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What did We See?

- Auditors follow GAGAS in their process
- First impressions matter
- “Get ready” documentation is focus and tailored to the Registered Entity
- More audit work is done off-site than on (on-site fieldwork is used to clean up data points and reinforce evidence)
- View of compliance program is based on off-site work
- Registered entity is included in the pre-audit and preliminary audit process
- Audit teams are divided by Reliability and CIP disciplines
- Internal controls and business processes are not necessarily examined in detail or relied upon for testing
- Reporting tools are well developed and utilize technology



14

What have we heard about the audit process in some regions?

- **Auditors are knowledgeable**
- **There is not consistency between auditors and regions in audit approach**
- **Evidence documentation sufficiency varies**
- **Sampling is being used or considered in some regions**
- **The Registered Entity’s Compliance Program is key and the first step in evaluation of compliance**
- **The RSAWs rule**
- **Evidence takes various forms – *Documentation, confirmation, interviews***
- **Evidence must be provided by the close of the fieldwork process**
- **Consistent point – The Registered Entity must provide the evidence and prove their compliance**

- **Process is evolving**
- **Evidence standards are becoming more standardized but have a way to go**
- **The onus is on the Registered Entity to prove compliance (as ordered by FERC)**
- **First impressions matter**
- **Skills of your staff in preparing documentation and interview participation are very important**
- **Evaluate your organization’s internal processes for strong controls, good documentation and evidence – improve them before the audit – don’t wait until your audit**
- **Do a self-assessment before the audit and after the audit – should become part of ongoing internal business process**

Summary



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- **Any questions? Please contact:**



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