



January 28, 2009

## FERC Guidance Order on Compliance Audits by NERC and the Regional Entities

On January 15, 2009, the Federal Energy Regulatory Commission (FERC) issued an order providing guidance to the North American Electric Reliability Corporation (NERC) and the eight Regional Entities to which NERC has delegated certain responsibilities with regard to conducting audits of registered entities' compliance with mandatory FERC-approved electric reliability standards.<sup>1</sup>

FERC issued the Guidance Order based on FERC staff observations that additional consistency in compliance audit processes among NERC and the Regional Entities would be beneficial. FERC instructs NERC and the Regional Entities to implement the new guidelines, as appropriate, in ongoing compliance audits and in all compliance audits that commence on or after the date of the Guidance Order.

### I. Background

NERC and the eight Regional Entities conduct compliance audits of registered entities that are subject to mandatory reliability standards pursuant to FERC-approved procedures adopted under Sections 215(c)(2)(C) (certification of NERC as the Electric Reliability Organization (ERO)) and 215(e)(4) (approval of Regional Entity delegation agreements) of the Federal Power Act.<sup>2</sup> These provisions require, among other things, that NERC, as the certified ERO, and the Regional Entities provide fair and impartial procedures for enforcement of reliability standards. NERC oversees the conduct of such audits pursuant to Section 3.1 of NERC's Compliance Monitoring and Enforcement Program (CMEP), which FERC approved on April 19, 2007.<sup>3</sup> NERC and the Regional Entities are required to base their compliance audit processes on recognized professional auditing standards, such as Generally Accepted Accounting Standards, Generally Accepted Government Auditing Standards, and standards sanctioned by the Institute of Internal Auditors.<sup>4</sup>

For more information, contact:

**Neil L. Levy**  
(202) 626-5452  
nlevy@kslaw.com

**Bruce L. Richardson**  
(202) 626-5510  
brichardson@kslaw.com

**David G. Tewksbury**  
(202) 626-5454  
dtewksbury@kslaw.com

**Brandon C. Johnson**  
(202) 626-5409  
bcjohnson@kslaw.com

**King & Spalding**  
**Washington, DC**  
1700 Pennsylvania Avenue, NW  
Washington, DC 20006-4706  
Tel: (202) 737-0500  
Fax: (202) 626-3737

[www.kslaw.com](http://www.kslaw.com)



## Global Transactions Practice Group

### II. Guidance on Pre-Audit Procedures

FERC suggests that NERC, in the context of developing, reviewing and updating its pre-audit questionnaires, should ensure that audit team requests for information and documents are as consistent as possible among the Regional Entities. To facilitate such consistency, FERC first proposes that all audit teams use a database consisting of a spreadsheet-based checklist of all the reliability standards requirements that are to be audited. Second, audit teams should request that registered entities: (1) organize responses to data requests and other audit evidence into the format that the audit team will use to match this information to compliance with particular requirements; (2) cross-reference the information provided to specific requirements of the reliability standards being audited; and (3) label all information that is responsive to a particular request relating to specific requirements.

FERC further recommends that audit teams allot sufficient time to review the responses to pre-audit data requests before beginning site visits. As part of pre-audit preparation, FERC suggests that compliance audit teams identify and examine any mitigation plans and associated documentation pertaining to reliability standards requirements to be audited, including, where applicable, an assessment of whether mitigation plans or milestones have been completed in a timely manner and whether completion was sufficient to bring the registered entity into compliance with applicable requirements.

### III. Guidance on Procedures during the Compliance Audit

FERC explains that an audit team's function is to ascertain whether the registered entity is in compliance with a requirement or whether there is any evidence that a violation has occurred. FERC emphasizes that NERC and the Regional Entities need to be as consistent as possible about the level of evidence or documentation that is required to demonstrate compliance. Conversely, an audit team should not consider or discuss potential monetary penalties or other sanctions with the audited entity, nor should a compliance audit team base its decision as to whether evidence of a violation exists upon the resources or time needed for litigation or settlement of a related notice of alleged violation. FERC will look with disfavor on conclusions of a compliance audit that are based on these considerations.

Expanding the scope of the audit function, FERC recommends that a compliance audit should include an assessment of the registered entity's compliance program and suggests that NERC and the Regional Entities discuss how NERC's audit guidelines and audit data requests and questionnaires could better elicit information on the factors discussed in FERC's recent policy statement on compliance.<sup>5</sup>

Additionally, FERC states that, if a compliance audit team discovers a situation that may constitute or become a violation, it expects the team to notify the registered entity of the situation, discuss it with the registered entity, and document the discussions in the compliance audit report. FERC also directs that compliance audit teams are expected to fully test compliance with any non-actively monitored standard if the teams find evidence during the audit of non-compliance with such standard.



## Global Transactions Practice Group

### IV. Guidance on Audit Team Leadership and Training

With respect to audits of registered entities or affiliates, FERC notes that NERC staff sometimes leads compliance audit teams in which Regional Entity staff participates to eliminate perceptions that a Regional Entity's compliance staff is not sufficiently independent from the audited entity. FERC directs NERC staff to control the scope and conduct of such NERC-led audits and not to seek advice from Regional Entity staff as to the direction or findings of the audit, while Regional Entity staff should serve as subject matter experts. FERC adds that this guidance does not apply where NERC leads an audit for other reasons, such as when NERC staff has specialized technical knowledge of particular standards.

FERC also suggests that NERC and the Regional Entities should ensure that their audit staffs receive training on interviewing, choosing samples of matters to be audited, and evaluating evidence, as the receipt of such training will ensure compliance with CMEP Section 3.1.5, which requires each audit team member to have successfully completed all NERC or NERC-approved Regional Entity auditor training applicable to the audit.

*King & Spalding is an international law firm with more than 880 lawyers in Abu Dhabi, Atlanta, Austin, Charlotte, Dubai, Frankfurt, Houston, London, New York, Riyadh (affiliated office), San Francisco, Silicon Valley and Washington, DC. The firm represents half of the Fortune 100 and in Corporate Counsel surveys consistently has been among the top firms representing Fortune 250 companies. For additional information, visit [www.kslaw.com](http://www.kslaw.com).*

*This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice.*

---

<sup>1</sup> *Guidance Order on Compliance Audits Conducted by the Electric Reliability Organization and Regional Entities*, 126 FERC ¶ 61,038 (2009) (Guidance Order).

<sup>2</sup> 16 U.S.C. §§ 824o(c)(2)(C) and 824o(e)(4) (2006).

<sup>3</sup> *See North American Electric Reliability Corp.*, 119 FERC ¶ 61,060 at P 41 (2007).

<sup>4</sup> *See North American Electric Reliability Corp.*, 122 FERC ¶ 61,245 at P 42 n.29 (2008).

<sup>5</sup> *See Compliance with Statutes, Regulations, and Orders*, 125 FERC ¶ 61,058 (2008).