Regulatory compliance

Taking a proactive approach to assessing the effectiveness of regulatory compliance programs

Periodic risk assessments of the regulatory landscape are instrumental in building and sustaining effective regulatory compliance programs.

Regulatory acts like Dodd-Frank, the Clean Air Act and the Energy Policy Act, along with the promulgation of rules by the Commodity Futures Trading Commission, Environmental Protection Agency (EPA) and Federal Energy Regulatory Commission (FERC)/North American Electric Reliability Corporation (NERC) continue to redefine the compliance landscape for the power and utility industry.

As a result, power and utility companies struggle to systematically identify, measure, prioritize, streamline and respond to established, modified and new regulatory compliance risks.

Putting the company's reputation on the line

Recent changes in regulatory procedures have resulted in more public exposure of potential compliance violations putting a company's reputation at risk.

In the past, FERC staff investigations were held in confidence until completed and a settlement was reached or a show-cause order issued. Due to new FERC procedures, in December 2011, FERC staff publicly released a preliminary findings report citing a power trading entity had allegedly violated FERC's long-standing prohibition against the manipulation of electric markets for financial gain.

This procedural change puts the company's reputation at risk until a final resolution of the alleged violations are determined and made public.

Although companies feel the pain from the financial penalties for noncompliance, the greater harm is the damage to a company's reputation. Therefore, it is important that all employees understand their role in maintaining the trust of key stakeholders, such as regulators, stockholders and rate-payers, and are encouraged to do the right thing at the right time, every time, to avoid public scrutiny.

Increasing costs in enforcement activities

Over the last 16 months ending March 2012, FERC approved regulatory compliance settlement agreements with companies amounting to over $265 million. These settlements resolved violations of ISO/RTO tariff requirements and NERC Standards and natural gas open access transmission rules. In addition, there are regulations related to electric market-based rates and Electric Quarterly Reports filing requirements, and alleged electric market manipulation.

Furthermore, while not resulting in financial penalties, FERC's Office of Enforcement conducted numerous investigations and audits requiring companies to realign their personnel resources to respond to regulator inquiries in order to protect their interests, instead of focusing on the company's core business.

Routine investigations and audits have become the norm since regulatory agencies have gained additional authority to enforce new or enhanced actions.

Implementing a robust compliance program that identifies high-risk activities before they are detected by the regulator helps companies decrease the risk of fines and avoid the potential of pulling valuable resources from their day-to-day responsibilities.

Building uncertainties into the company's strategic plan

Compliance programs should include the uncertainties surrounding regulatory requirements that affect significant capital projects and investments. By addressing the uncertainties, the compliance program is better aligned with the company's strategic initiatives, rather than treated as a policy vehicle.

For example, the EPA announced its new Cross-State Air Pollution Rule (CSAPR) with the intent to improve air quality by cutting SO_2 and NOx emissions from facilities, such as coal-fired generation, that contribute to pollution in other states. This rule, initially scheduled to become effective on January 1, 2012, ended up in the courts. On December 30, 2011, the U.S. Court of Appeals stayed the rule, effectively postponing implementation of the regulation. Resolution of the court action is expected sometime in 2012. Even though the regulation is still being debated within the court system, implications of the possible court rulings need to be considered within both current and long term corporate strategic plans.

Assessing the effectiveness of your regulatory compliance program

Whether regulations are new, established or pending, compliance continues to challenge companies to the point where they should re-evaluate the effectiveness of their regulatory compliance programs.

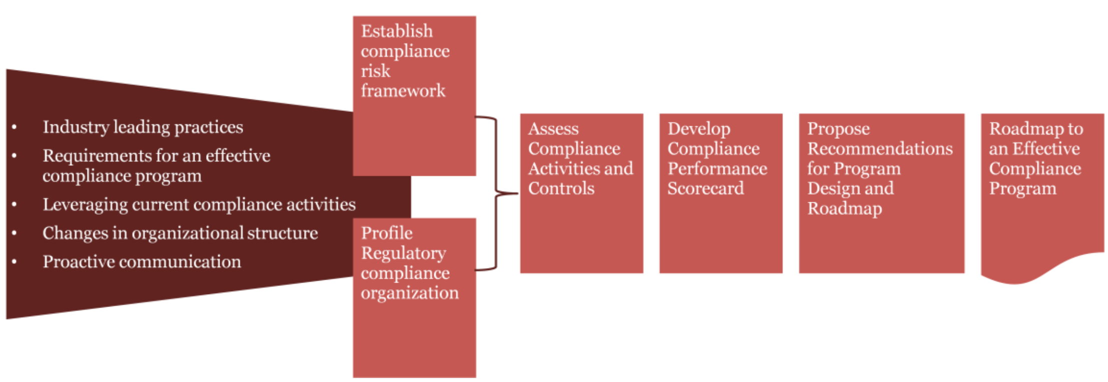
By performing a risk assessment periodically for existing and new regulations, companies can evaluate whether their regulatory compliance programs are mitigating the 'right risks'. Too many companies find themselves spending time on issues that are no longer important while not addressing pending or existing compliance matters that could have more serious implications if ignored.

PwC's regulatory compliance team can work with your company to assess your regulatory compliance program. We will leverage our team's deep knowledge of current and pending regulations in addition to providing a roadmap on how best to apply leading practices within the industry.

PwC applies the following steps in building and assessing a compliance framework (see Figure 1 below):

Figure 1

PwC's Compliance Framework Assessment Approach



Establishing a compliance risk framework

We work with your company to document the extent of your compliance environment, identify higher-risk areas and establish categories of compliance commitments that reflect the way your compliance processes are organized.

Developing a profile of the regulatory compliance organization

In collaboration with your company, we compile a list of your compliance activities and controls in comparison to your categorized compliance commitments. The focus of this analysis is to identify existing compliance activities and controls being performed by personnel and automated systems.

Assessing compliance processes and controls

By focusing on processes, activities and information systems, we assess the adequacy and effectiveness of your compliance activities and controls, where applicable, against the:

- Federal Sentencing Guidelines for Organizations' elements of an effective compliance program
- Compliance program requirements set forth in FERC's Policy Statement on Enforcement
- Corporate and business unit compliance objectives
- Company's risk profile
- Leading practices in the power and utilities industry

Developing a compliance scorecard and providing recommendations

Finally, we develop a compliance performance scorecard that rates the effectiveness of existing compliance activities, controls and systems across the compliance categories and commitments. In addition, we provide recommendations to improve your regulatory compliance program and suggest a high-level roadmap for the successful implementation of these enhancements.

The advantage of PwC's approach lies in the development of a compliance framework that clearly identifies which compliance commitments are viewed by stakeholders as higher risk, based on the likelihood and impact of a compliance failure. Further, the compliance scorecard provides insight into the level of compliance measures in place for each compliance commitment.

Advantages of periodic assessments

By taking a proactive approach to assessing the effectiveness of your organization's regulatory compliance program, your organization can:

- Decrease monetary and non-monetary penalties associated with regulatory non-compliance.
- Effectively manage regulatory challenges by concentrating your compliance program and resources on higher risk areas.
- Be instrumental in the creation of methods to implement regulations and monitor compliance.

Once implementing a robust compliance framework as described above, you will have greater confidence that you are efficiently addressing the current compliance regulations while also conducting the necessary diligence on how best to address pending regulatory matters.

pwc.com/us/utilities

To have a deeper conversation about any of the issues in this paper, please contact:

Alan Conkle
Power and utilities principal
Phone: (313) 394.6969
E-mail: alan.conkle@us.pwc.com

Tim Cherry
Power and utilities director
Phone: (213) 830-8305
E-mail: timothy.r.cherry@us.pwc.com

Saul Armenta
Power and utilities director
Phone: (213) 217-3390
E-mail: saul.g.armenta@us.pwc.com