



Compliance Audit Report Public Version

**Potomac Electric Power Company
(PEPCO)**

NCR00881

**Confidential Information (including Privileged and
Critical Energy Infrastructure Information)
Has Been Removed**

April 29-30, 2008

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Executive Summary

Potomac Electric Power Company (PEPCO) is registered as a Distribution Provider (DP), a Transmission Owner (TO), a Load Serving Entity (LSE) and Purchase-Selling Entity (PSE) within the ReliabilityFirst region.

The on-site compliance audit of PEPCO was conducted, by ReliabilityFirst Corporation, on April 29-30, 2008 at the PEPCO offices located in Bethesda, Maryland. In preparation for the audit, PEPCO supplied various materials as evidence of compliance with the requirements in twenty-seven (27) NERC reliability standards and one (1) ReliabilityFirst standard. The audit team reviewed and evaluated all the material supplied by PEPCO. As a result, PEPCO was found to be compliant with all twenty (20) of the applicable twenty-seven (27) NERC Reliability Standards and one (1) ReliabilityFirst Standard. Seven (7) of the (27) NERC Reliability Standards were deemed to be not applicable to PEPCO after review by the audit team.

PEPCO had no ongoing mitigation plans to review at this time. PEPCO's transition plan to comply with ReliabilityFirst Bulk Electric System (BES) definition was taken into account during this audit.

Audit Process

The compliance audit process steps are detailed in the NERC and ReliabilityFirst Compliance Monitoring and Enforcement Program (CMEP). The NERC and ReliabilityFirst CMEP generally conform to the United States Government Accountability Office Government Auditing Standards and other generally accepted audit practices.

Objectives

All Registered Entities are subject to audit for compliance with all reliability standards applicable to the functions for which the Registered Entity is registered.¹ The audit objectives are:

- Review PEPCO's compliance with the requirements of the reliability standards that are applicable to PEPCO based on PEPCO's registered functions.
- Validate compliance with applicable reliability standards from the NERC 2008 Implementation Plan list of actively monitored standards and other standards deemed appropriate to PEPCO's functional registration.
- Validate evidence of self-reported violations and previous self-certifications, confirm compliance with other requirements of the reliability standard, and review the status of associated mitigation plans.
- Document the Potomac Electric Power Company's compliance program and culture.

¹ North American Electric Reliability Corporation CMEP, paragraph 3.1, Compliance Audits

Scope

The PEPCO compliance audit included all reliability standards that are applicable to PEPCO and monitored in the NERC Implementation Plans for the period June 18, 2007 to March 31, 2008. The scope of the on-site compliance audit was part of the regularly scheduled cycle and was not due to or as part of a compliance investigation.

PEPCO is subject to monitoring by ReliabilityFirst on a three year basis. This audit included those standards which were in NERC's 2008 CMEP Implementation Plan. ReliabilityFirst can monitor all applicable ReliabilityFirst standards, self certifications and mitigation plans as appropriate

Confidentiality and Conflict of Interest

Confidentiality and Conflict of Interest of the audit team are governed under the ReliabilityFirst Delegation Agreement with NERC and the NERC Rules of Procedure Section 1500. PEPCO was informed of the ReliabilityFirst obligations and responsibilities under the agreement and procedures. The work history for each audit team member was provided to PEPCO. PEPCO was given an opportunity to object to an audit team member on the basis of a possible conflict of interest or the existence of other circumstances that could interfere with the audit team member's impartial performance of duties. PEPCO did not submit any objections by the stated fifteen day objection due date and by this action accepted the audit team member participants without objection.

All members of the team, that audited PEPCO, are members of the ReliabilityFirst Staff and are bound by the NERC Rules of Procedure and the confidentiality that is within that FERC filed document.

On-site Audit

PEPCO is subject to an audit once every three years, at the minimum, as provided by the NERC Rules of Procedure. Sixty (60) days prior to this scheduled audit, PEPCO had been provided with a pre-audit package which included all the necessary documents and information, required by NERC and ReliabilityFirst, to complete the audit process. This pre-audit package included the following:

- 60 day Notification letter which contained a request for evidence, information and data submittals
- Audit Survey
- Audit Agenda as applicable
- Audit Team Work History with discussion of objection process
- General Instructions of Data or Information Submittals
- Reliability Standard Auditor Worksheets (RSAWs)
- Reliability Standard Questionnaires

Documents were provided to PEPCO in electronic format.

ReliabilityFirst had discussed with PEPCO the usage of technical experts and agreed to allow the usage of technical experts by PEPCO as it deemed necessary to explain their compliance to the reliability standards.

PEPCO had been notified to provide any technical experts or personnel it deemed necessary to provide an understanding of the evidence provided to meet compliance.

In evaluating the scope of this audit, the audit team leader did not request specific interviews with PEPCO employees representing subject matter expertise regarding all of registered functions of PEPCO. During the audit discussions did take place where points of clarification and application of methodologies were needed. These discussions provided the audit team with evidence validating compliance with certain reliability standards.

At times, and in accordance with generally accepted government auditing standard 3.31, auditors used professional judgment in planning and performing audits and attestation engagements and in reporting the results.

Additionally, and with the generally accepted government auditing standard 3.39, while this standard places responsibility on each auditor and audit organization to exercise professional judgment in planning and performing an audit or attestation engagement, it does not imply unlimited responsibility, nor does it imply infallibility on the part of either the individual auditor or the audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud. Professional judgment does not mean eliminating all possible limitations or weaknesses associated with a specific audit, but rather identifying, considering, minimizing, mitigating, and explaining them.

An audit agenda and/or schedule had been provided to PEPCO in advance to allow the necessary time to prepare for the audit. ReliabilityFirst and the audit team appreciated PEPCO's cooperation and flexibility with the agenda

Methodology

ReliabilityFirst conducted this audit via the on-site method. Sixty (60) days prior to this scheduled audit, PEPCO had been provided with a pre-audit package which included all the necessary documents and information, required by NERC and ReliabilityFirst, to complete the audit process. Upon receipt and review of the submitted information the audit team reviewed the information and evidence for compliance to the applicable standards. With reviews completed on applicable requirements, the audit team conducted an on-site visit that concluded with an exit briefing to provide the entity with the team findings. An audit report, summarizing the audit activities and results, was compiled in a public and non-public version and submitted to the audited entity for review for accuracy in documented evidence. Once finalized, the audit report will be submitted to NERC for posting. The on-site audits followed the following format.

Audit Overview

Upon arrival at PEPCO, an Opening Briefing was conducted to discuss the following items:

- Introduction of audit team
- Audit Objective and Scope
- Team Audit Expectations
- Interviews and Discussion for Clarification
- Audit Process
- Exit Briefing and schedule

Audit

The approach used by the Reliability*First* Audit team was to review each reliability standard and applicable requirement and then evaluate PEPCO's evidence demonstrating compliance to the requirement within each standard. When there was concern that the supporting evidence did not demonstrate compliance to the requirement, clarification was requested from PEPCO. Any additional supporting evidence was NOT permitted to be newly created and the editing of any existing material and/or documents, initially submitted as evidence of compliance by PEPCO, was NOT permitted.

Exit Briefing

An exit briefing was conducted with a presentation for PEPCO. The Reliability*First* audit team and the PEPCO teams both participated. The audit process was again reviewed and a timeline for completing the audit report was reviewed. If a possible violation would have been identified during the audit they would have been reviewed during the discussion of our preliminary results during the exit briefing. PEPCO was given an opportunity to ask questions of the audit team throughout the exit briefing. Moreover, the audit team did identify a few recommendations on quality of evidence that were reviewed with PEPCO. These recommendations will be provided to PEPCO as part of the exit briefing slides and if requested, in a separate document and not as part of the audit report. This is required as specified in section 3.1.6 of the Uniform Compliance Monitoring and Enforcement Program of the North American Electric Reliability Corporation

Company Profile

PEPCO is a regulated electric utility that provides transmission and distribution services and is a wholly owned subsidiary of Pepco Holdings, Inc. (PHI). Pepco delivers electricity to more than 760,000 homes and businesses in the District of Columbia and its Maryland suburbs. As of 12/31/2007, PEPCO has the following break down in circuit miles of transmission:

- 500 kV: 142.79 miles
- 230 kV: 747.43 miles
- 138 kV: 72.22 miles
- 115 kV: 38.09 miles

This total includes aerial and underground circuits and a jointly owned 500 kV circuit in Pennsylvania which is not connected to PEPCO. It should be noted that PEPCO has no NERC/ReliabilityFirst standard responsibility for this jointly owned line.

The PEPCO customer base as of 12/31/07 is:

- Residential: 686,636
- Commercial: 73,335
- Industrial: 0
- Other: 131 (Street Lights)

The peak load of the company was recorded during the summer of 2006 at 6,947 MW, which is also the historic peak load for PEPCO. In general, PEPCO is normally a summer peaking company.

PEPCO owns no generation, but does have a System Operations Center that operates on a 7 by 24 basis. PEPCO is a member of the PJM Regional Transmission Organization (RTO) and participates in the PJM energy market.

Audit Specifics

The compliance audit was conducted on April 29 -30, 2008 at the Potomac Electric Power Company offices in Bethesda, MD.

Audit Team Role	Title	Company
Lead Auditor	Manager, Compliance Support Services	ReliabilityFirst
Team Member	Sr. Engineer	ReliabilityFirst
Team Member	Sr. Consultant	ReliabilityFirst
Team Member	Sr. Consultant	ReliabilityFirst

PEPCO Audit Participants

Title	Company
President and COO	PEPCO Holdings Inc. (PHI)
Sr. VP - Asset Management and Planning	PHI
VP Electric Operations	PHI
VP Transmission	PHI
Mgr Control Room Operations	PEPCO
Sr. Auditor	PHI

Title	Company
Mgr Transmission Compliance	PHI
Mgr Protection & Telecom Ops	PEPCO
Transmission Policy Mgr	PHI
Mgr Operations Eng Planning & Analysis	PHI
Director System Operations	PHI
Mgr Electric Maintenance	PEPCO
Mgr Vegetation Maintenance	PHI
Staff Forester	PEPCO
System Forester	PHI
Lead Engineering Associate	PEPCO
Mgr Transmission Services Group	PHI
Lead Engineering Associate	PHI
Mgr Engineering Projects	PEPCO
Lead Engineer	PHI
Mgr Security Liaison & Investigations	PHI
Consulting Engineer	PEPCO
Mgr Corp Security Group	PHI
Mgr Emergency Management	PEPCO
Lead Engineering Associate	PEPCO
Lead Engineer	PEPCO

Audit Results

All evidence was reviewed and validated during the on-site audit for compliance to the standards and requirements. Where the evidence was not deemed sufficient or a clarification was required, PEPCO was asked and allowed to provide additional supporting detail and/or examples of how compliance was met. No new documents were permitted or edits to existing documents allowed. Examples of adherence to compliance were required to be in the form of real-time applications and/or dated material to prove the entity's process and/or procedures were being followed.

Findings

The following table details the summarized auditor notes relating to evidence reviewed for compliance with the reliability standards monitored for compliance.

Standards and Requirements that were reviewed and that are applicable to PEPCO

Reliability Standard	Requirement	Finding
BAL-005-0	R1.	Compliant
CIP-001-1	R1.	Compliant
CIP-001-1	R2.	Compliant
CIP-001-1	R3.	Compliant
CIP-001-1	R4.	Compliant
EOP-002-2	R9.	Compliant
EOP-004-1	R2.	Compliant
EOP-004-1	R3.	Compliant
FAC-003-1	R1.	Compliant
FAC-003-1	R2.	Compliant
FAC-003-1	R3.	Compliant
FAC-008-1	R1.	Compliant
FAC-008-1	R2.	Compliant
FAC-008-1	R3.	Compliant
FAC-009-1	R1.	Compliant
FAC-009-1	R2.	Compliant
INT-001-2	R1.	N/A
INT-004-1	R1.	N/A
INT-004-1	R2.	N/A
IRO-001-1	R8.	Compliant
IRO-004-1	R4.	Compliant
IRO-005-1	R13.	Compliant
MOD-010-0	R1.	Compliant
MOD-010-0	R2.	Compliant
MOD-012-0	R1.	Compliant
MOD-012-0	R2.	Compliant
MOD-017-0	R1.	Compliant
MOD-019-0	R1.	Compliant
PRC-004-1	R1.	Compliant
PRC-004-1	R2.	N/A
PRC-004-1	R3.	Compliant
PRC-005-1	R1.	Compliant
PRC-005-1	R2.	Compliant
PRC-008-0	R1.	Compliant
PRC-008-0	R2.	Compliant

PRC-010-0	R1.	N/A
PRC-010-0	R2.	N/A
PRC-011-0	R1.	N/A
PRC-011-0	R2.	N/A
PRC-016-0	R1.	N/A
PRC-016-0	R2.	N/A
PRC-016-0	R3.	N/A
PRC-017-0	R1.	N/A
PRC-017-0	R2.	N/A
PRC-021-1	R1.	N/A
PRC-021-1	R2.	N/A
TOP-002-2	R3.	Compliant
TOP-002-2	R18.	Compliant
TOP-005-1	R4.	Compliant
VAR-001-1	R5.	Compliant
BAL-502-RFC- 01	R2.	Compliant
BAL-502-RFC- 01	R5.	Compliant

Compliance Culture

PEPCO's compliance culture is summarized in a PEPCO document titled, "NERC/ERO Compliance Monitoring and Enforcement Program for PHI's Utility Operating Companies".

A PHI-wide executive level Steering Committee (the "NERC/ERO Compliance Steering Committee" or "Steering Committee") was established in 2006 for the oversight and coordination of PHI's compliance activities for ensuring 100% compliance with all applicable standards including voluntary standards. This PHI-wide Steering Committee meets on a regular basis to review ReliabilityFirst's annual plans, PHI's major compliance activities and plans. In addition, a subset of this Steering Committee meets on a monthly basis to review PHI's utility operating companies (PEPCO, Delmarva and ACE) specific activities. Committee Charter: a. PHI NERC/ERO Compliance Steering Committee: Membership includes executives of each of PHI's lines of business as well as PHI's Vice President and General Auditor. The Committee meets monthly and reports into both the Executive Vice President and Chief Operating Officer and PHI's Corporate Risk Management Committee. Internal program includes:

- Each applicable NERC standard assigned to a PHI executive based on area of responsibility
- NERC standards awareness for responsible individuals
- Executive-level Steering Committee for oversight
- Day-to-day monitoring of compliance
- Collect Annual Plan and status reports
- Review/develop documentation (e.g. document repository/management system).
- Provide management reports
- Compliance monitoring and monitoring system (e.g. AssurX – Monitoring Tool)

- Ensure an independent assessment of compliance with applicable standards
- Encourage self-reporting of any potential violations for immediate action