



“Challenges and the Future of Internal Audit”

Presented by
Paul W. Friel, Vice President and General Auditor
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Agenda

- About Pepco Holdings, Inc.
- Internal Audit Challenges
- Current Internal Audit Challenges
- The Future
 - The Third Line of Defense
 - Internal Audit at a Crossroads
- Keys to Internal Audit Success
- Who Is The Internal Auditor of the Future?

About Pepco Holdings, Inc.

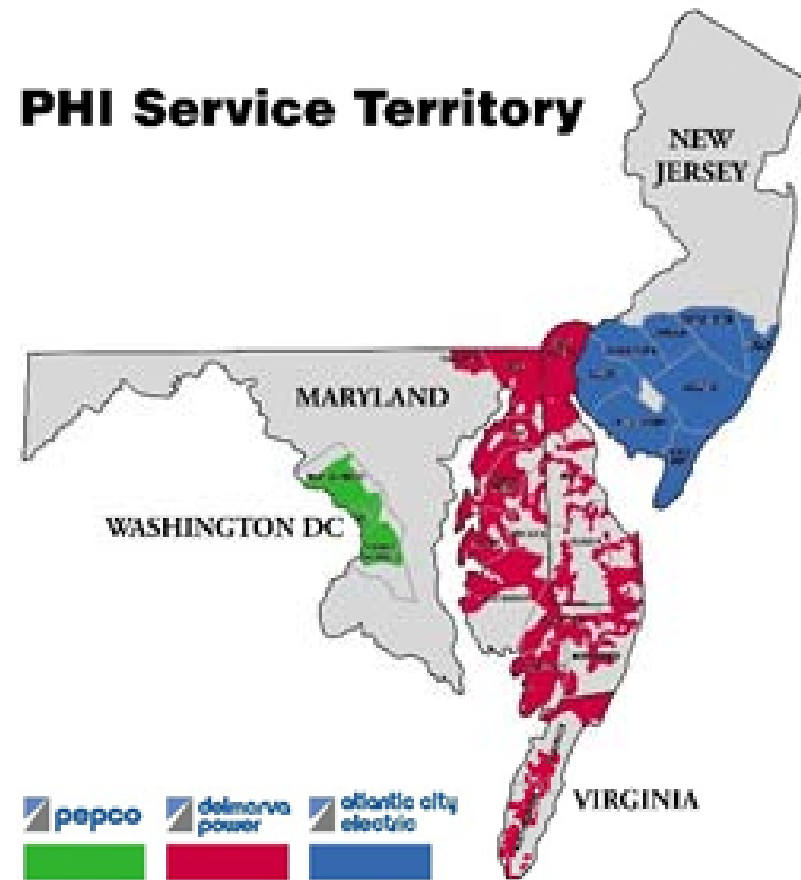


PHI is an energy holding company engaged in regulated utility operations and sale of competitive energy products and services to residential and commercial customers.

PHI delivers electricity and natural gas to more than 1.9 million customers in Delaware, the District of Columbia, Maryland, and New Jersey, making it one of the largest electricity delivery companies in the mid-Atlantic region.

PHI companies have combined assets of more than \$12 billion and combined revenues of \$8.4 billion, delivering about 50,000 gigawatt-hours of power annually.

PHI Service Territory



About Pepco Holdings, Inc.



Power Delivery



Electric

Electric

Gas

Electric

Customers	▶ 767,000	▶ 498,000	▶ 122,000	▶ 547,000
GWh	▶ 26,863	▶ 13,015	▶ N/A	▶ 10,089
Mcf (000's)	▶ N/A	▶ N/A	▶ 20,300	▶ N/A
Service Area <i>(square miles)</i>	▶ 640	▶ 5,000	▶ 275	▶ 2,700
	▶ District of Columbia, major portions of Prince George's and Montgomery Counties	▶ Major portions of Delmarva Peninsula	▶ Northern Delaware	▶ Southern New Jersey
Population	▶ 2.1 million	▶ 1.3 million	▶ .5 million	▶ 1.1 million

Note: Based on 2008 annual data

About Pepco Holdings, Inc.



PHI provides competitive wholesale generation services through **Conectiv Energy** and retail energy products and services through **Pepco Energy Services**.

Conectiv Energy operates in the deregulated energy industry, safely and responsibly managing power plant assets and buying and selling fuel and energy in the wholesale marketplace.

Pepco Energy Services is a leading provider of deregulated energy and energy-related services for residential, small business and large commercial customers.



About Pepco Holdings, Inc.



Transmission & Distribution



2009 – 2013
Forecast
Business Mix*



70 – 75%

Competitive Energy / Other



25 – 30%

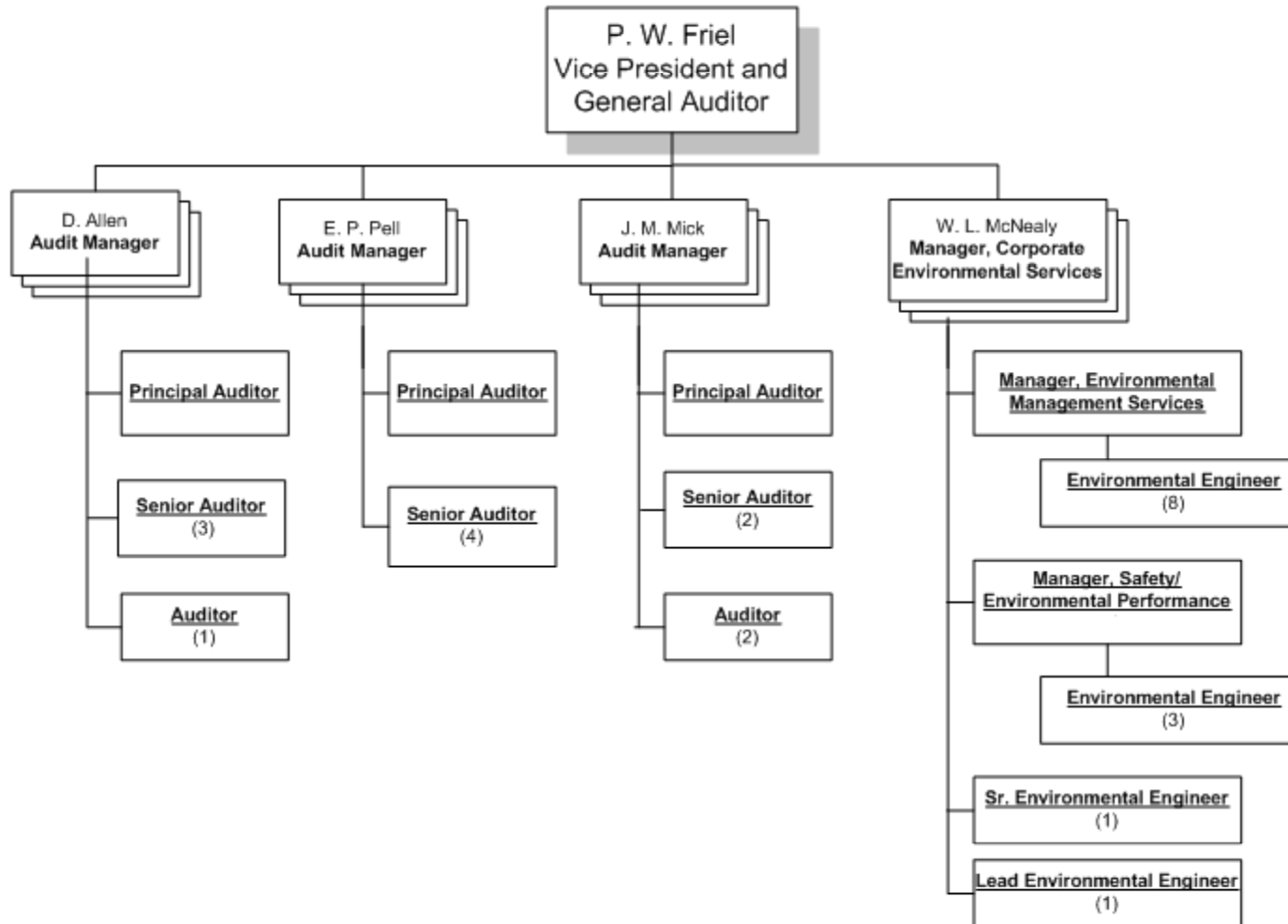
PHI Investments

* Percentages based on projected operating income.

About Pepco Holdings, Inc.



PHI Internal Audit & Environmental Services Organization



Responsibility and Accountability



PHI Internal Audit is responsible and accountable for:

- Furnishing the Audit Committee and management of Pepeco Holdings, Inc. and its business units with independent assurances regarding the integrity and adequacy of internal controls and corporate governance processes.

How

- Perform Operational, Financial and Compliance reviews

Internal Audit Challenges

- Ad-Hoc Management Requests
- Delaware Implementation – Advanced Metering Infrastructure
- Economic Meltdown 2008-2009
- Significant Business Process Changes
- Maintaining and Developing a Skilled Staff
- Coordination of New Jersey Board of Public Utilities Comprehensive Management Audit
- Increase in Major Construction Programs
- Acquisition of Conectiv
- Sale of Generation Assets
- Deregulation
- SOX Compliance 2004
- Developing and Implementing Sustainable SOX Program 2005

Current Internal Audit Challenges

- Maintaining and Developing a Skilled Staff
- Understanding and Auditing New Processes and Technology
 - Advanced Metering Infrastructure in Other Jurisdictions
 - Implementation of New Business Processes
 - Increased Compliance Auditing
- Increased Emphasis on Enterprise Risk Management and Corporate Governance
- Impact of a Changed Economy and its Impact on our Businesses
- Increased Regulatory Audits
- IFRS

The Future



“By 2012, strategic internal audit groups will be providing risk assurance as well as controls assurance as part of coordinated efforts to keep in step with corporate advances in risk and control processes. To cope with increased time pressures and competing priorities, internal auditors will devote more time to risk management, fraud, internal controls, and process flows.”

*--PricewaterhouseCoopers, Internal Audit 2012**

The Third Line of Defense

“Internal Audit is the Third Line of Defense providing assurances that risk management processes are adequate and appropriate.”

*--Excerpt from KPMG report to PHI Audit Committee –
“PHI Risk Governance Assessment”, July 2009*

The Third Line of Defense

Risk Process and Content Monitoring

- **Liaise with senior management and / or Board.**
- **Rationalize and systematize risk assessment and governance reporting.**
- **Provide oversight on risk management content / processes, followed by second line of defense (as practical).**
- **Provide assurance that risk management processes are adequate and appropriate.**

Internal Audit at a Crossroads– New Strategic Path

A controls-focused approach has dominated internal audit and has been assimilated into the audit cycle.

Internal Audit may need to evaluate a more comprehensive approach to audit, risk assessment, and risk management that extends beyond the current focus on controls, and which will enhance internal audit's functional value at a time when risk assessment and risk management have become primary stakeholder concerns.

Keys to Internal Audit Success

It is not enough for internal audit merely to assess the effectiveness of financial and operational controls and to provide assurance on compliance with laws and regulations.

- Be relevant, not redundant.
- Stay ahead of business trends rather than lagging behind them.
- Leverage the power of technology.

Who is the Auditor of the Future?

The auditor of the future should have the following skills:

- Strong data mining, extraction and analysis skills to access, assess, and analyze business risks and management's plans for mitigating these risks;
- Understand enterprise-wide risk, fraud prevention and detection, and governance and compliance issues;
- Understanding of measures to prevent and detect fraud, assess fraud risk and identify fraud indicators; awareness of financial fraud schemes and scenarios, knowledge of forensic investigations;
- Understanding risk factors and related control implications in order to provide more timely risk and control assurances and update organizational risk profiles;
- Integrated skills in finance and technology;

Who is the Auditor of the Future?

The auditor of the future should have the following skills:

- Audit and assess complex IT environments, and technology risks;
- Financial expertise to assess the adequacy of financial / internal controls, and the ability to detect financial statement fraud, which requires a firm understanding of financial reporting standards;
- A deep understanding of their company and of the industry or industries that company serves, and sufficient industry knowledge to identify industry trends (and the risks associated with these trends);
- Strong communication skills, the ability to conduct interviews, and the confidence and communication skills to discuss findings, trends and perceived risks with management.

Questions?