



## Muskrat Falls Project

Report Name :

Internal Audit Project # 15-07  
Invoice Attest and Payable Audit

Person Responsible: John Skinner  
Auditor: Alison Ball  
Audit Lead: Doug Woodford  
Audit Manager: Jackie Borden

Date: September 22, 2015



**AUDIT REPORT**

<b>Line of Business</b>	Lower Churchill Project
<b>Department</b>	Finance and Accounting – Accounts Payable Function
<b>Audit</b>	Invoice Attest and Payable Process
<b>Audit Risk Level</b>	Medium
<b>Person Responsible</b>	John Skinner – Accounting Manager
<b>Copy</b>	Jim Meaney – GM Finance, LCP
<b>Supervisor</b>	Gerald Cahill, Project Controller
<b>Auditor</b>	Alison Ball
<b>Audit Manager</b>	Jackie Borden

**EXECUTIVE SUMMARY**

A review of the internal controls within the Lower Churchill Project (LCP) Accounts Payable Function displays alignment with several of the COSO Internal Control Framework Principles relating to the control environment, risk assessment, information and communication as well as monitoring processes.

In addition, the invoice attest processes for the Prism and PM+ Cost Management Systems, as well as the data exchange process, displayed internal controls that were effective in mitigating the risk of paying unauthorized costs. This was further supported by detailed tests of controls that had very few exceptions relating to non-compliance other than those noted below.

A good practice was observed in relation to the weekly metrics that are reviewed by the Accounting Manager to monitor invoice processing turnaround days.

The following low and medium risk audit issues were observed as a result of the audit program that was executed:

1. LCP Accounts Payable Resource Constraint - Risk Management
2. Ability of Cost Analysts to edit the Data Exchange Upload File
3. Invoice data not consistently posted in Prism Cost Management System

The following opportunities for improvement were noted as a result of the invoice attest compliance tests that were performed:

1. Updating Financial Authority Approval Matrix
2. Non-Resident Withholding Tax (NRWT) Documentation
3. Budget Holder Guidance

Please see attached report for further details on the audit program that was executed as well as the issues and opportunities for improvement that were observed.

## Objectives

- (1) To review the Finance & Accounting (F&A) Accounts Payable control environment, risk assessment process, information and communication methods as well as monitoring activities.
- (2) To review the LCP invoice attest and payment process to determine if adequate internal controls exist. This will also include a review of the data exchange procedure.
- (3) To test compliance of the above noted process with attested invoices.

## Scope

The PM+ Cost Management System is used to manage costs for the majority of construction related contracts related to Muskrat Falls, the Labrador Transmission Asset and the Labrador Island Link. The Prism Cost Management System is used to manage the majority of personnel contracts, and all other project costs including legal, consulting, and Strait of Belle Isle Contracts.

Both the Accounts Payable Procedure PM+ and the Accounts Payable Procedure Prism were reviewed as the process for each is slightly different.

Tax compliance was excluded from this audit scope with consideration given to withholding tax treatment only. A review of the data exchange procedure was performed as well.

The audit examined all pertinent steps up to the point that the invoices are ready to pay. The actual payment from JD Edwards will need to be addressed in a separate audit if necessary.

If a payment certificate was required, a high level assessment of appropriate signatures was performed as part of the invoice attest process. Compliance with the payment certificate procedure was not verified during this audit. That will form the basis of a future audit. A sample of rates was vouched back to the original contract as well.

This audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

## Background

The objectives of the LCP Finance and Accounting (F&A) Attest Function include ensuring invoices are:

1. Compliant with the contract and include all required supporting documentation.
2. Free of error or omissions.



3. Compliant with tax regulations.
4. Approved in accordance with the Financial Authority Procedure.
5. Coded to the appropriate code of accounts and line items.

The initial step of the audit process was reviewing key policies and procedures as well as interviewing the Accounting Manager to determine if the F&A Function complied with a selection of COSO Framework Principles relating to the control environment, risk assessment, information and communication, and monitoring activities. *COSO Internal Control – Integrated Framework 2013* is recognized as a leading framework for designing, implementing, and conducting internal control and assessing the effectiveness of internal control.

The second step of the audit involved reviewing the attest process as it relates to each of the two cost management systems, Prism and PM+, to ensure that adequate controls exist. To execute this step of the audit a combination of procedural document reviews, interviews, and process walkthroughs were completed. In addition to the above noted attest process, the data exchange process was analyzed using the same steps to ensure that adequate controls exist.

The data exchange process begins with the creation of an electronic data file that contains invoice data that is ready for payment. The file is uploaded by Nalcor Energy Corporate Finance into JD Edwards to allow for more efficient data processing of LCP invoices.

Finally, detailed compliance testing was performed to ensure that the invoice attest processes and controls are being adhered to. A sample of 28 invoices was selected with a total dollar value of \$160,894,000. Multiple tests were performed including invoice and tax recalculation, ensuring adequate approvals and proof of work were obtained, checking to ensure correct posting to GL and cost control systems, as well as agreeing rates to original contracts or purchase orders.

## **Analysis**

### **1. Review of application of COSO Principles for F&A Accounts Payable Group**

#### **Control Environment**

The F&A Team is adequately structured to allow for appropriate levels of supervision and oversight. There are several key management plans and procedural documents that provide guidance to the F&A Accounts Payable Team on the functions overall objectives. The individual attest procedures provide each Cost Analyst with a detailed guide of the various steps required for the attest process.

Weekly and monthly team meetings are held to discuss performance as well as to share any information or concerns that may impact the attest process.



### **Information and Communication/Monitoring Activities**

A detailed orientation checklist is prepared and completed upon hiring of new Cost Analysts to the department. Weekly Key Performance Indicator (KPI) Reports are generated for each Cost Analyst on a weekly basis and are reviewed by the Accounting Manager to determine if there are any significant delays or problem areas related to the invoice attest process. The current goal of a 30 day invoice turnaround has been satisfied with the exception of invoices that may contain an isolated issue. As a result, the team is working towards a 23 day invoice attest turnaround.

Ongoing monitoring of present controls and procedures occurs on regular basis by the Accounting Manager. These changes are communicated with the rest of team and procedural documents are formally updated when it is deemed that there are a reasonable number of changes to justify a reissuance.

### **Risk Assessment**

The Accounts Payable Risk Management Plan addresses risk management steps that have been created for the F&A Accounts Payable Function including evaluating each contract using the risk matrix impact and likelihood methodology. This evaluation is completed annually and assists with determining contracts that have a higher risk from an invoicing perspective.

A detailed review of this plan determined that there is a medium risk resource constraint related to the execution of assurance engagements by the Accounts Payable Function in relation to the risk assessment process noted above. Please see the attached issue report relating to this finding.

## **2. Review of Invoice Attest Processes for Adequacy of Controls**

The design of the invoice attest demonstrates the necessary internal controls required for this function. Through discussions with various Cost Analysts, the F&A Accounts Payable Team are quite knowledgeable about the attest process which further strengthens the controls that are in place. A detailed walkthrough of the attest process further supported the adequacy of the controls.

The data exchange process is also operating effectively with the exception of a low risk issue relating to the read/write access of two of the data files. Please see attached issue report for a detailed discussion.

## **3. Compliance Testing**

Overall, the invoices that were tested complied with all of the necessary controls with the exception of three invoices that were not posted to the Prism Cost Control System. Issue report #3 addresses this medium risk issue in detail.



The following are some suggested opportunities for improvement for the invoice attest process based on the compliance tests that were performed:

1. **Updating Financial Authority Approval Matrix** – It was noted during the testing phase that an individual with granted financial authority has a new role on the project but the authority matrix still had him listed with his old position title. It was recommended that this change be made to avoid confusion and ensure compliance.
2. **Non-Resident Withholding Tax (NRWT) Documentation** –It is recommended that adequate documentation is attached to invoices with respect to any NRWT calculations or adjustments. This should include evidence of the review performed by Corporate Tax such as an email or memo. This would provide clarification for any future reviews of the invoice by either external or tax auditors.
3. **Budget Holder Guidance** - It is recommended that a high level document be prepared that provides guidance or 'rules of thumb' for the assignment of contract packages for budget holders. This document would aid in clarifying budgetary responsibilities in case of further review by outside parties.

### **Conclusion**

To conclude, a review of the internal controls within the Lower Churchill Project (LCP) Accounts Payable Function displays alignment with several of the COSO Internal Control Framework Principles relating to the control environment, risk assessment, and monitoring processes.

In addition, the invoice attest processes for the Prism and PM+ Cost Management Systems, as well as the data exchange process, displayed internal controls that were effective in mitigating the risk of paying unauthorized costs. This was further supported by detailed tests of controls that had very few exceptions relating to non-compliance other than those noted above.

**AUDIT ISSUE #1: LCP Accounts Payable Resource Constraint - Risk Management**

<b>Line of Business</b>	Lower Churchill Project
<b>Department</b>	Finance and Accounting – Accounts Payable Function
<b>Audit</b>	Invoice Attest and Payable Process
<b>Issue Risk Level</b>	Medium
<b>Person Responsible</b>	John Skinner – Accounting Manager
<b>Copy</b>	Jim Meaney – GM Finance, LCP
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During the audit it was determined that the LCP F&A Accounts Payable Function does not have adequate resources in place to address identified risks as part of their AP Risk Management Processes.

Per review of Section 7.2 to 7.4 of the AP Risk Management Plan, the following excerpt contemplates the execution of audits (if necessary) by the F&A Team:

*“When deemed necessary, a customized audit plan tailored to mitigate contractual risk associated with a particular contractor.”*

The AP Risk Management Plan also contemplated an LCP F&A Audit Lead with the following responsibility description:

*“LCP F&A team member or designate assigned the responsibility to plan, execute and report on an audit performed for the LCP F&A Team.”*

The F&A Accounts Payable Function did highlight several areas of risk related to specific contractors as outlined in their 2015 audit plan. Although they have engaged an external consultant to assist with one of the planned risk areas, there are still several other areas of concern that presently do not have assigned resources.

The risk mitigation steps as outlined in the AP Risk Management Plan are not adequately addressed without the completion of the proposed attest/audit areas by the LCP Accounts Payable Team. Adequately addressing these risks would further support overall compliance with COSO risk assessment Principle 7: “The organization identified risk to the achievement of its objective across the entity and analyses risks as a basis for determining how the risk should be managed.”

The risk of not completing the proposed audit areas could result in certain costs being billed to the project in error as a result of the identified risks.



## **RECOMMENDATION**

It is recommended that the LCP F&A Team determine an appropriate plan of action to address some of the contractor invoicing concerns that they have raised in their 2015 audit plan. Although a detailed audit may not be feasible or necessary, it is recommended that a course of action be taken to ensure that there are no significant concerns with the audit areas identified.

## **FORMAL MANAGEMENT RESPONSE**

By way of background, when the LCP F&A organization was first established in early 2011 there was recognition of the need for both tax and audit support for the Project. This was noted in organizational charts from that period. Rather than duplicating those functions in the LCP F&A organization, it was envisioned that we would draw on the corporate tax and audit organizations to provide that support; a common strategy implemented on mega project that members of the LCP F&A team were previously involved with.

The interface with Corporate Tax has been established for some time and works very effectively. As issues arise LCP F&A engage the corporate tax group to address the issues and provide tax advice and direction. Additionally the corporate tax group has been proactive by providing periodic tax seminars to the LCP F&A Team.

Based on recent discussions with Corporate Internal Audit, it appears the evolution of the financial audit interface will take a different direction. In past mega projects that LCP F&A team members have been involved with, the technical audit function is embedded in the project (e.g. Safety, Environment, Quality) primarily because it is an integral part of work execution and in ensuring control and compliance by the contractors during work execution. Unlike the technical audits, the financial audits are generally an "after the fact audit" and have always been executed by the corporate (or joint venture) auditors; not the project accounting team. Internal Audit advised they have not resourced to perform the financial audit function noted above based on the mandate that has been provided by the Nalcor Audit Committee. Similarly, based on what was envisioned for the LCP F&A team, there are currently no resources in place to address this requirement.

The AP Risk Management Plan noted in the finding was developed by LCP F&A to be a guide in identifying financial risk assessments (by contract) on the Project. It essentially mirrors the Internal Audit risk assessment procedure. It was not intended to portray the view that the audit function was embedded in the LCP F&A Team. The procedure has been used to identify risk areas and the results of the (annual) assessments have been communicated to Internal Audit with the expectation that they would play an integral role in the execution of the recommended audits.

Where financial risk exists on the Project, it is imperative that the work be completed. In light of recent discussions with Internal Audit and recognition that their role will be different than what was originally envisioned, the LCP F&A team as the financial stewards of the Project will find ways to address our risk concerns and minimize financial risk.



**AUDIT ISSUE 2: Ability of Cost Analysts to Edit Data Exchange Files**

<b>Line of Business</b>	Lower Churchill Project
<b>Department</b>	Finance and Accounting – Accounts Payable Function
<b>Audit</b>	Invoice Attest and Payable Process
<b>Issue Risk Level</b>	Low
<b>Person Responsible</b>	John Skinner – Accounting Manager
<b>Copy</b>	Jim Meaney – GM Finance, LCP
<b>Supervisor</b>	Gerald Cahill, Project Controller
<b>Auditor</b>	Alison Ball
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The invoice data upload files that are created for the data exchange process has read/write access. The Cost Analysts are required to make small formatting edits to both the source data file from PM+ and the export file from LCP Data Tracker so that the data can be uploaded into JDE for payment.

These two files should be read only in order to reduce the potential for errors in the invoice data that will be uploaded into JDE. This risk could increase the potential for incorrect amounts and/or incorrect vendors being paid.

**RECOMMENDATION**

It is recommended that the necessary programming changes be made to either PM+ or to the LCP Data Tracker to ensure that the data in the upload file is in the correct format for uploading to JD Edwards without manual intervention by a Cost Analyst.

It should be noted that Corporate Accounting performs a compensating control by reviewing the data that was uploaded to JDE and cross checks it back to the data exchange report prior to upload.

**FORMAL MANAGEMENT RESPONSE**

The LCP F&A management team is aware of the formatting edits required to be made to data exchange files. These formatting edits include the following:

- Removal of comma’s in text fields prior to upload into IDCS.
- Correcting the format of dollar amounts once downloaded from IDCS.



In 2013 we explored options to fix this issue including hiring a software company to modify IDCS system software but the cost was deemed excessive and came with other risks. Due to the fact that the risk was considered low and PM+ was scheduled to be phased out in the coming months, no action was deemed necessary by Management.

Recent events have questioned the phasing out of PM+, particularly in the near term. Even though LCP F&A management deem the risk associated with this to be low, we have asked IS to conduct an assessment once again to determine if an economical and secure solution can be found.

**AUDIT ISSUE #3- Invoice data not posted in Prism Cost Management System**

<b>Line of Business</b>	Lower Churchill Project
<b>Department</b>	Finance and Accounting – Accounts Payable Function
<b>Audit</b>	Invoice Attest and Payable Process
<b>Issue Risk Level</b>	Medium
<b>Person Responsible</b>	John Skinner – Accounting Manager
<b>Copy</b>	Jim Meaney – GM Finance, LCP
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There were three occasions noted whereby the invoice module in the Prism Cost Management System was not updated with the invoice data after an invoice was attested and ready for payment.

There appears to be multiple causes for these omissions:

- Oversight by Cost Analyst
- Issues with system conversion from Prism Classic to Prism G2
- Cost codes and commitment breakdown needed to be updated in Prism

One of the key benefits of updating Prism with invoice data is that it provides an indication if the current commitment is reaching the maximum amount authorized for that particular contract or PO. Although the contract administrators are responsible for monitoring the spending of each contract/PO, the cost analysts also review these limits to determine if a payment can be made.

If invoice data is omitted from Prism, there is a risk that a particular contract or PO may be overcommitted, resulting in unauthorized spending.

**RECOMMENDATION**

It is recommended that all known invoice data omissions from Prism be updated as soon as possible to minimize the risk of over-commitment with respect to a particular contract. With respect to updating the coding in Prism, the cost analysts should communicate with project controls the importance of updating this information in a timely manner. This will assist the cost analysts with entering the invoice data as soon as the invoice is ready to pay.

**FORMAL MANAGEMENT RESPONSE**

The issue of invoices not being posted in the cost control system before being sent to corporate for payment is restricted to Prism as invoices need to be entered into PM+ to facilitate processing. Regarding the causes of the issue noted above, we offer the following commentary:

- Oversight by Cost Analyst: We have addressed this issue with the Cost Analysts to reinforce the importance of ensuring invoices are entered into the system before being sent for payment. We will continue to reinforce this message.
- Issues with system conversion from Prism Classic to Prism G2: It was identified shortly after implementation of Prism G2 that certain invoices were excluded from the conversion. This issue was addressed in two ways:
  1. For a period of time after conversion to Prism G2 each Cost Analyst examined invoice history for each contract package assigned to them to ensure all invoices processed were entered into the system, particularly related to the period of time excluded during the system upgrade.
  2. Project Controls conducted a reconciliation of invoice data in Prism Classic and Prism G2 to ensure all invoices previously entered in Prism Classic were successfully transferred into Prism G2.

We consider this matter closed.

- Cost Code and Commitment Breakdown Needed to Be Updated in Prism: Based on the Financial Authorization Procedure and other related management plans, Requisitions would be approved, contracts would be awarded and cost control systems would be updated long before an invoice is received by the LCP accounts payable team. Unfortunately, there have been instances where this sequence of events have not occurred in as timely a manner and the accounts payable team has received an invoice with one or all of the above not in place. The LCP F&A team has gone to great lengths to improve on these issues, but there is still room for improvement. We maintain a log of recurring invoicing issues and address issues with those who fail to comply with project management plans. In rare cases, Management may have a need to pay a Contractor without delay and therefore authorize payment prior to systems being updated. When this occurs, the Budget Holder and LCP F&A management are aware of and approve the payment. The Cost Analyst is actioned to ensure the invoice is subsequently entered into the system once it is updated with the necessary contract and commitment information.