



Lower Churchill Project

Internal Audit Project # 17-30

Report Name:
Lower Churchill Project Conflict of Interest
Audit

Person Responsible: Faustina Cornick
Auditor: Julian Chafe
Audit Manager: Jackie Borden

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Line of Business	Lower Churchill Project (LCP)
Department	People Relations
Audit	LCP Conflict of Interest Audit
Audit Risk Level	Medium
Person Responsible	Faustina Cornick – Human Resources Manager
Copy	Elaina Janes, Pat Hussey, Lance Clarke, Ron Power, Stephen Follett, Paul Harrington, John MacIsaac, Gilbert Bennett, John Skinner, Tanya Power
Auditor	Julian Chafe
Audit Manager	Jackie Borden

Executive Summary

An audit was conducted to assess conflict of interest (COI) on the Lower Churchill Project (LCP), including assessing the adequacy of controls around disclosure, management, and mitigation of potential conflicts of interest.

Internal Audit has concluded that the LCP has the basic elements of a conflict of interest management process in place, mirroring the approach taken at Nalcor Energy. This is a good starting point and allows for some steps to be taken to manage conflict of interest, however, a more detailed and robust approach would be preferred and should be developed. As it stands, conflict of interest on the LCP is being managed in the context of the policies that are currently in place. One medium risk issue has been identified in regards to this, along with a number of good practices and opportunities for improvement. For more detail, please see the full audit report.

To improve management of conflict of interest, Internal Audit recommends a detailed conflict of interest procedure be developed which focuses on education and communication regarding conflict of interest. This would be the responsibility of Nalcor Energy and should be adopted in full by the LCP.

See the summary of the scope and results below, with further details within the audit report.

Audit Scope Summary and Results

Audit Scope	Result
Control Environment	
Conflict of Interest Policy in use that defines COI and provides examples	✓
Policy outlines expectations of employees	✓
Policy identifies positions responsible for overseeing COI process	Issue #1
Policy communicates reporting mechanisms and advocates a risk based approach	Issue #1
Policy updated regularly	✓

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Reporting Mechanisms	
COI log in use for managing and tracking mitigation of COIs	Issue #1
Potential COIs identified have been adequately managed and mitigated	✓
Mechanism in place to report COIs to senior management and if applicable, the Board of Directors	Issue #1
Compliance Testing	
All independent companies with multiple consultants identified and mitigating procedures put in place to prevent COI	✓
Any other potential COIs identified any mitigated	✓

✓ - Satisfactory

Internal Audit Report

Objective

The objective of the audit is to ensure that the project management team has procedures in place for the effective management of conflicts of interest (COI). This includes identifying conflicts of interest, maintaining a conflict of interest log, and establishing mitigation plans to address conflicts of interest.

Scope

The scope of the audit will be focused on independent consultants comprising the senior management team. The audit will consist of a review of policies/procedures for adequacy, as well as compliance testing.

Background

Given the complexity of the project, with almost 500 personnel from recruitment service providers and independent consultants, it is reasonable to expect that potential conflicts will arise from time to time. How these conflicts are managed and mitigated is a factor in the success of the project. Conflict of interest has the potential to have a direct impact on cost and public perception of the project.

Analysis

The audit consisted of examining the control environment for conflicts of interest, the reporting mechanisms in place, as well as compliance testing.

Auditing of the control environment focused on whether there was a conflict of interest policy in place and if it contained the elements expected in a well-developed policy. These include a clear definition of

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conflict of interest, expectations of employees/project delivery team, roles and responsibilities for managing conflicts, communication, and reporting mechanisms.

The review of reporting mechanisms focused on whether or not a conflict of interest log was being used to track and manage conflicts, how conflicts are being disclosed, how/if they are mitigated, and how they are reported to senior management or the Board of Directors where appropriate.

Compliance testing was focused on identifying all independent consultants on the LCP and their related companies/organizations in an effort to determine if any were in a conflict of interest situation and whether or not it had been disclosed and mitigated.

Control Environment

There are currently two documents in use governing conflict of the interest on the LCP. There is the Nalcor Code of Conduct and Business Ethics Handbook, which is signed off by every LCP team member during the orientation process. There is also a master service agreement (MSA) template used for developing MSAs with recruitment agencies. This template contains a clause governing COI and the agencies and consultants are bound to follow this when they enter into a service agreement. In this regard, an RSP would have an obligation to disclose a COI to the LCP if one of its contractors informs them of a potential conflict. Depending on the recruitment service provider being used, the RSP may have additional COI policies in place for its employees.

The Code of Conduct and Business Ethics Handbook defines COI as an activity that adversely affects or could affect the performance of a Nalcor employee; or an activity that could offer a personal advantage because of employment at Nalcor. It then goes on to list specific activities deemed to be a COI, including: entertainment, gifts, favors, and outside business interests. The MSA template defines COI as a consultant accepting a mandate that puts them in conflict with company interests. It does not include specific activities deemed to be COIs.

The Code of Conduct outlines expectations of employees as related to COI. It refers to the Conflict of Interest Act and the requirement that all employees comply with the spirit and intent of the Act. It goes on to provide tips to avoiding conflict of interest, as well as expectations for disclosure. The MSA template also outlines expectations as follows: "On an ongoing basis, Consultant shall ensure that it will not accept a mandate which would put it in Conflict with Company interests. In the event that any Conflict of Interest should be identified, it will be immediately communicated to the Company and a mutually satisfactory resolution determined."

Neither of these documents explicitly states who is responsible for managing the conflict of interest process with regards to mitigation, logging, tracking, etc. However, the Code of Conduct states that any potential COI is to be disclosed to the employee's supervisor, manager, or vice president. The MSA template simply states that COI be immediately communicated to the Company. The Code of Conduct only goes as far as disclosure; it does not delve into how to proceed in resolving the COI. The MSA

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template states that a "mutually satisfactory resolution" should be determined, but it does not delve into how this will be accomplished.

Overall the LCP has the basic elements of a conflict of interest management process in place. However, a more detailed and robust approach would be preferred and should be developed. As it stands, conflict of interest on the LCP is being managed adequately within the context of the policies that are currently in place. There was one medium risk issue identified for this procedure. For more detail, please see the attached issue report at the end of this audit report.

Reporting Mechanisms

There is a COI log in place for the LCP, but it is not used regularly or updated regularly. The intent of this audit procedure was to examine the log and assess its usefulness in managing potential COIs. This included examining:

- a. Did investigation/discussion occur to determine whether or not a conflict actually exists?
- b. Was it determined how the conflict will be resolved and if disciplinary action is necessary?
- c. Are COIs being investigated in a timely manner by the person responsible?
- d. Evaluate the actions taken to remedy COIs and assess for reasonableness
- e. Where COIs are voluntarily disclosed, are they reported to the appropriate management level (i.e. supervisor of the employee who made the disclosure)?

As there is essentially no log in use, this procedure was completed by interviewing key individuals regarding management of COI. It appears these steps are being followed, albeit in a more informal manner in the absence of formal logging and tracking of disclosed COIs. When a potential COI is disclosed to a consultant's supervisor, discussions are held between the consultant, supervisor, human resources, senior management, etc. about how to proceed in a mutually satisfactory manner. Several instances of this were identified during the compliance testing (further detail below). Through these interviews and discussions, it appeared that these identified instances were handled adequately within the guidance provided by the existing policies. However, there are benefits to be gained by incorporating the use of a COI log as an element of a more robust and detailed procedure.

Additionally it was determined that no formal reporting relationships for reporting COIs to management, the Board, etc. are defined by the current policies. Reliance is placed on day to day working relationships to communicate COI issues. During the interviews conducted it was stated that these relationships are well known by management. It was noted during the audit that the LCP reports on conflict of interest to Nalcor on an annual basis for inclusion in Nalcor's consolidated Board report. There is a full record of this reporting. This is a positive finding; however this is again something that should be a documented requirement in a more detailed procedure.

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Lack of a COI log, along with no formal defined reporting relationships can lead to a reduced level of control over managing conflict of interest. These findings are issues and are addressed in the medium risk issue first identified in the analysis of the Control Environment.

Compliance Testing

A listing was created during the audit containing all independent consultants working on the LCP. This listing was then further condensed to summarize only instances whereby more than one independent consultant was working on the LCP from the same company. There were some instances of this noted. Ownership structure for these companies were reviewed to determine if any of the independent consultants on the LCP were in an ownership position of the company they were affiliated with while also having other members of their company employed on the LCP. In each instance where this occurred, steps were taken to avoid any potential COI. Several of these instances occurred while putting in place the initial owner's team and as such were disclosed to management. Other instances have been reviewed as they arise. This typically involves input from Human Resources and relevant members of the Senior Management Team. Additionally, these cases were analyzed to determine if there any groups of consultants who are being paid at higher rates than other personnel completing similar scopes of work. No instances of this were identified.

Testing was also conducted around family relationships. Some instances of family relationships exist on the LCP. They are all handled uniquely based on the individual situation. Reporting relationships and authorizations are restricted in these cases, i.e. pay rate increases, timesheets, etc. Rate increases are all handled via HR. No concerns were noted. The main concern from LCP when filling a position is that the individual is right for the role, and that the rate that they are paid is acceptable. The recruitment process acts as a control for this by having multiple senior management positions involved in recruitment, rate negotiation, and expenditure authorization, which would limit the ability of an independent owner in recruiting their own people and then paying them a higher rate than warranted. No one individual is in a position to have sole control over this process.

In summary, several instances of potential conflict of interest were identified during the execution of the audit program. These were discussed with LCP Management and appeared to be adequately mitigated given the measures currently in place and when accounting for the lack of a formal, detailed COI procedure. While disclosure of COI is mandatory in the existing policies, there is a lack of controls to enforce this, and as such it puts the onus on the consultant to disclose any potential conflicts. If this is not done, there could be potential for an individual to benefit at the expense of the LCP/Nalcor. This presents an issue, and it is addressed in the medium risk issue first identified in the analysis of the Control Environment.

Findings

Good Practices

A number of good practices were identified during the audit:

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1. The Code of Conduct and Business Ethics Handbook is included with company supplied documents provided to recruits and recruitment agencies. This supplements the clause in the MSA template governing COI.
2. No sign off of timesheets occurs between individuals from the same recruitment agency.
3. When the role of an individual on the LCP changes such that they would be in a potential COI, steps are taken to move the individual from employment as recruitment agency personnel to an independent consultant.
4. An annual meeting is held with all recruitment service providers to review LCP policies and procedures for the recruitment/hiring process. This includes a review of the Code of Conduct and Business Ethics Handbook, including COI.

Opportunities for Improvement

One opportunity for improvement was noted during the audit:

1. The Code of Conduct and Business Ethics Handbook could be posted on LCP home page (The Current), as it is on Nalcor Website. It is currently posted, but it is buried in the human resources section.

Issues

A single issue was identified during the course of the audit:

1. There is no detailed conflict of interest management procedure in place on the LCP. As such, several elements for managing COI are either lacking or missing entirely, including:
 - a. who is responsible for the COI process (i.e. reporting, consolidation, logging, mitigation, resolution, etc.),
 - b. how to resolve or mitigate the risk associated with COI,
 - c. formal reporting relationships for reporting COI to management, the Board of Directors, etc.,
 - d. regular and consistent use of a COI log, and
 - e. controls to enforce mandatory COI disclosure.

For more detail on this issue, please see the attached issue report at the end of this audit report.

Conclusion

Internal Audit has concluded that the LCP has the basic elements of a conflict of interest management process in place, mirroring the approach taken at Nalcor Energy. This is a good starting point and allows for some steps to be taken to manage conflict of interest, however, a more detailed and robust

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approach would be preferred and should be developed. As it stands, conflict of interest on the LCP is being managed in the context of the policies that are currently in place.

Internal Audit recommends that a detailed conflict of interest procedure be developed which focuses on education and communication regarding conflict of interest. This would be the responsibility of Nalcor Energy and should be adopted in full by the LCP.

More discussion of the issue identified can be found in the issue report at the end of this report.

The Audit Team would like to extend its thanks to the management and staff involved in this audit for their cooperation throughout the audit process.

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AUDIT ISSUES

Issue #1

Issue Title: There is no detailed conflict of interest management procedure in place on the LCP.

Risk Level: Medium

Issue: Managing conflict of interest is important for any company as it helps to protect the financial interests of the company, as well as public perception of the company. There are two documents in use on the LCP that address conflict of interest. These are the Master Service Agreement template and the Nalcor Code of Conduct and Business Ethics Handbook. While these documents contain high level guidance on managing conflict of interest, they do not get into the level of detail that would be expected. If conflict of interest is not thoroughly managed there is an increased risk that an entity or individual could receive an undue benefit from the company.

The LCP (and Nalcor Energy) have been relying on the Code of Conduct and Business Ethics Handbook to manage and govern conflict of interest to date. A lack of a detailed conflict of interest procedure could lead to inadequate controls over conflict of interest on the Lower Churchill Project. This could lead to increased risk of financial impacts in the form of overpaid compensation, hiring of underqualified individuals, as well as negative public perception of the project. If conflict of interest is not managed on the project, there is potential that independent consultants are being paid more than is reasonable, that they are recruiting other members of their organizations for work on the project in exchange for financial incentives, etc. Given the complexity of the project, with almost 500 personnel from RSPs and independent consultants, it is reasonable to expect that potential conflicts of interest will arise from time to time.

Recommendation:

It is recommended that a detailed conflict of interest procedure be developed which focuses on education and communication regarding conflict of interest. Responsibility for this procedure would fall to Nalcor Energy, not the LCP. Such a document should include elements such as:

- responsibilities for specific positions within a line of business that are in charge of the conflict of interest process and are responsible for logging, consolidating, mitigating, resolving, and reporting on potential conflicts of interest;
- defined reporting relationships within management, the executive, and the Board of Directors;
- a conflict of interest log for tracking and managing potential conflicts;
- a conflict of interest questionnaire to be incorporated into the recruitment/procurement process to ensure open and timely disclosure of any conflicts of interest; and

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- a flowchart to thoroughly outline the steps in the process.

It is recommended that the LCP adopt this procedure in full once issued by Nalcor Energy.

Formal Management Response:

Based on Internal Audit's recommendation that Nalcor Energy should develop a detailed Conflict of Interest procedure, the Lower Churchill Project will adopt in full once the procedure is implemented.