



Nalcor Energy Internal Audit

Ethics Line Report 8, 9, 11
Conflict of Interest and Procurement

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Table of Contents

Objective 2

Executive Summary..... 2

Complaint summary..... 2

Internal Audit Process..... 2

Summary of Facts..... 3

Recommendations 5

 Audit Committee requests..... 5

 Internal Audit recommendations..... 5

Appendix A – Contracts..... 6

Objective

Review three complaints received through Ethicsline in late January 2018 regarding Lower Churchill Management Corporation (LCMC) and [REDACTED]

Executive Summary

Three complaints were received via Nalcor Energy's Ethics Line related to the contracts awarded to [REDACTED]. An investigation was completed by Internal Audit related to the three contracts from both a conflict of interest and procurement point of view. The audit has concluded that current Nalcor Energy processes are followed, in that sole sourcing was approved and potential conflict of interest was disclosed.

A summary of the facts were discussed with the Chief Executive Officer (CEO) and the Audit Committee. The Audit Committee requested that additional documentation be provided to explain the sole sourcing of these contracts. The [REDACTED] presented this to the Lower Churchill Project Board of Directors. The Board was satisfied with the presentation and explanation. The [REDACTED] also provided an additional written memo to the Manager, Internal Audit to explain the sole sourcing decision. The Audit Committee also requested confirmation that no financial benefits were received by the [REDACTED] or family members. Both verbal and written confirmation of this was provided by the [REDACTED]

Internal Audit has made recommendations related to the procurement processes to increase consistency between contracts and demonstrate work scopes were appropriately pre-approved. This has been completed. Internal Audit has also made recommendations related to conflict of interest processes at a corporate level.

A summary of contracts is included in Appendix A - Contracts.

Complaint summary

- Allegation 1 - During the General Electric (GE) contract settlement in December 2017, terms and conditions were added into the agreement that resulted in [REDACTED] being awarded a \$4-5 million contract. As an [REDACTED] has significant access to corporate information. (Ethics line #8)
- Allegation 2 - [REDACTED] has special deal with [REDACTED] and recruiting LCP contractors to work for [REDACTED]. Sole source process being abused. (Ethics line #9)
- Allegation 3 - [REDACTED] has inside knowledge of rates paid to other LCP contractors ([REDACTED] [REDACTED]) and has now recruited them and contracted them back to the Project. (Ethics line #11)

Note: [REDACTED] also noted in complaint 3. This was not covered in this review.

Internal Audit Process

Based on the allegations received, Internal Audit collected and reviewed the contracts, communications, procurement documentation and other documentation as deemed appropriate and presented the consolidation of these facts to the Chief Executive Office and the Audit Committee of the Board of

Directors. Any actions or changes requested by the CEO or Audit Committee would be implemented. Any Internal Audit procedural recommendations would then compliment these actions.

Summary of Facts

Complaint 1 re: [REDACTED]

- The [REDACTED] signed in December 2017 contained a requirement for “additional resources” to be added by [REDACTED] at cost to LCMC for \$4m (for people) and \$1m (for training)). These resources must be agreeable to the Lower Churchill Management Corporation (LCMC).
- LCMC sent communication to [REDACTED] in January 2018 deeming [REDACTED] as acceptable resources for this. In contract terms, when resources must be agreed upon by both parties, deeming a contractor acceptable would be normal. However, this would be a conflict as [REDACTED] has a contract for oversight of [REDACTED] (LCMC contract) and they were involved in [REDACTED] settlement process.
- [REDACTED] approached [REDACTED] and Internal Audit confirmed that [REDACTED] declined to complete any work related to LCMC due to conflict of interest.

Conclusion - Complaint 1

Based on the review of the settlement contract and subsequent communication between [REDACTED] LCMC and [REDACTED] inappropriate procurement did not occur. [REDACTED] communicated to [REDACTED] that they could not pursue the scopes of work within the settlement agreement due to conflict of interest.

Complaint 2 and 3 - Conflict of Interest, [REDACTED]

- [REDACTED] owners were previously in senior management position on the Lower Churchill Project. Prior to 2016, they were separate independent contractors that successfully completed the [REDACTED] component of the project. In late 2016, upon completion of [REDACTED] they disclosed to Nalcor management that they were forming [REDACTED]. Several controls were put in place at that time to manage the reporting relationships within the project of the [REDACTED]. This was fully disclosed and discussed in 2016.
- Upon completion of the [REDACTED] project knowledge, expertise and [REDACTED] Due to their [REDACTED] they were awarded a contract to support the [REDACTED]. This contract was sole sourced with a blanket contract (i.e. no set limit on contract with requisitions/releases to be issued). The same bill rates were used as when [REDACTED]. This contract was issued with a blanket purchase order which has an expiry date but the contract has no dollar value limit. Releases / individual scopes of work must be approved against the contract prior to the work commencing. To date, requisitions/releases have been issued for \$310,000 for [REDACTED] and \$66,000 for [REDACTED]. All contracts and other procurement documents were approved by, up to and including, the EVP, Power Supply.

- [REDACTED] This contract was sole sourced due to prior HVDC experience, as permitted within policy. Procurement documents indicated that other companies could not bid due a conflict of interest. IA was unable to verify other options. Sole source documentation indicated that benchmarking was completed, however, unable to locate documentation (primarily due to the individual involved in procurement for this contract is no longer on the project). IA, therefore, reviewed the rates on this contract compared to other engineers on the project. The lead [REDACTED] employee is paid higher than other engineers, however, HVDC expertise impacts rate, but it is unclear to what degree. Others are above average, but again, unclear to what degree the HVDC specialty impacts rates. (Note: compared to “lead” and “senior” engineers on LCP). During this review, additional information was obtained on the qualifications of the [REDACTED] team. [REDACTED]
- [REDACTED] All contracts and other procurement documents were approved by, up to and including, the EVP, Power Supply.
- In late 2017, [REDACTED] including the most senior resource who became a [REDACTED]
- [REDACTED] was subsequently awarded 2 contracts (as partial replacement of [REDACTED] contracts) to supply these former [REDACTED] employees to both LCMC (\$4.3m requisition) and Nalcor Energy (\$2.5 requisition). Both of these contracts were sole sourced at the same rate per hour for “key [REDACTED] employees. Additional scopes were added to one contract (e.g. GAP analysis) for non-[REDACTED] employees (other [REDACTED] personnel). A stakeholder/communication specialist was also added to the operating and maintenance contract (no billings for the stakeholder specialist to date).
- A review of the procurement documentations related to all three contracts found that the original scopes of work were vague. Prior to this review (January 2018), efforts were made by the LCMC management to improve this by using Work Task Order (WTO). Nalcor Energy has similar processes, but they were not fully implemented during this review.
- Other facts.
 - One [REDACTED] working still working on [REDACTED] (no longer part of project management team) under original Master Service Agreement.
 - [REDACTED] representatives no longer have access to systems, building and management meetings.

Conclusion - Complaint 2 and 3 - Conflict of Interest, [REDACTED]

Procurement - Power Supply awarded the contracts within policy. Sole sourcing justification was completed and approved at the appropriate level. Procurement documentation to manage the contracts had opportunities for improvement.

Conflict of Interest – In compliance with Nalcor Energy policy, both Power Supply management and [REDACTED] management disclosed [REDACTED] prior history with the project.

Recommendations

Audit Committee requests

Based on the Internal Audit discussion with the Audit Committee, two actions were requested, which were immediately completed by the [REDACTED]

1. Further demonstration/discussion to the Board of the sole source justification. The [REDACTED] presented a summary to the Lower Churchill Project Board of Directors. The Board was satisfied with the presentation and explanation. The [REDACTED] also provided a written memo further explaining the sole sourcing decision.
2. Declaration that the [REDACTED] and/or family are in no way connected to [REDACTED]. Internal Audit received both verbal and written confirmation of this, which has been communicated to the Audit Committee.

Status - Complete

Internal Audit recommendations

1. Procurement documentation. The contracts awarded by Nalcor Energy and Lower Churchill Project are managed differently. It is recommended that the contracts be administratively managed using the LCP procurement practices. Specifically:
 - a. Requisitions / release of contract amounts / work task orders are designed and approved prior to work scopes being started.
 - b. Time sheets are submitted and approved as time is incurred (on a weekly or bi-weekly basis), not at the time of the billing. Invoices also include hours billed, however, as the hours are tracked as incurred, at the time of billing this should be for administrative validation only.
 - c. Hours/bill amounts drawn down against requisitions. Additional requisitions/or work task orders are then approved as required.
 - d. As several contracts are in place, over several businesses, and with potentially some of the same people, it is recommended the cross referencing and/or a reconciliation of hours between contracts are completed. This will ensure that hours are not overbilled between contracts.

Status - Complete

2. Conflict of Interest processes. Although this engagement was process compliant, several recommendations were made at the corporate level to increase conflict of interest procedures. The current code of conduct, which covers conflict of interest, is an appropriate policy, however, these additional recommendations are intended to support the business and ease the process when potential conflicts are identified. This will be completed outside of this review by Corporate Human Resources and Corporate Legal.

Status – In progress

Appendix A – Contracts

