



UTILITY REGULATION AND COMPETITION OFFICE

Report to those charged with governance on the 2018 audit

11 DECEMBER 2019

*To help the public service
spend wisely*

TABLE OF CONTENTS

Introduction	2
AUDITOR'S RESPONSIBILITIES IN RELATION TO THE AUDIT.....	2
Auditor's responsibility under International Standards on Auditing.....	2
Responsibilities of Management and those charged with governance:	3
Other information in documents containing audited financial statements:.....	3
CONDUCT, APPROACH AND OVERALL SCOPE OF THE AUDIT.....	3
AUDIT REPORT, ADJUSTMENTS AND MANAGEMENT REPRESENTATIONS	3
SIGNIFICANT FINDINGS FROM THE AUDIT	4
Significant accounting practices:	4
Management's judgments and accounting estimates:	4
Going concern doubts:.....	4
Significant deficiencies in internal control:.....	4
Fraud or illegal acts:.....	5
Significant difficulties encountered during the course of our audit:.....	5
Disagreements with management:	5
Any other significant matters:	5
Acknowledgements	6
Appendix 1 – Summary of Adjusted Differences	7
Appendix 2 - Summary of Unadjusted Differences	8
Appendix 3 - Internal Control Matters & Significant Findings	9

REPORT TO THOSE CHARGED WITH GOVERNANCE

INTRODUCTION

1. We have completed our audit of the 31 December 2018 financial statements of the Utility Regulation and Competition Office ("the Office"). International Standards on Auditing (ISAs) require that we communicate certain matters to those charged with governance of the Office in sufficient time to enable appropriate action. The matters we are required to communicate under ISAs include:
 - auditors responsibilities in relation to the audit
 - the overall scope and approach to the audit, including any expected limitations, or additional requirements
 - relationships that may bear on our independence, and the integrity and objectivity of our staff
 - expected modifications to the audit report
 - significant findings from our audit
2. This report sets out for the consideration of those charged with governance those matters arising from the audit of the financial statements for 2017/18 that we consider are worthy of drawing to your attention, so that you can consider them before the financial statements are approved and signed.
3. This report has been prepared for the sole use of those charged with governance and we accept no responsibility for its use by a third party. Under the Freedom of Information Law (2018) it is the policy of the Office of the Auditor General to release all final reports proactively through our website: www.auditorgeneral.gov.ky.

AUDITOR'S RESPONSIBILITIES IN RELATION TO THE AUDIT

AUDITOR'S RESPONSIBILITY UNDER INTERNATIONAL STANDARDS ON AUDITING

4. ISAs require that we plan and perform the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Accordingly, the audit does not ordinarily identify all such matters and this report includes only those matters of interest which came to our attention as a result of the performance of our audit.

RESPONSIBILITIES OF MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE:

5. Management's responsibilities are detailed in the engagement letter to which this engagement was subject. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS:

6. We have not read any other information contained in the Utility Regulation and Competition Office's annual report to consider whether such information is materially inconsistent with information appearing in the financial statements or with our knowledge of the operations of the Office. We have not reviewed any other documents containing the Office's audited financial statements.

CONDUCT, APPROACH AND OVERALL SCOPE OF THE AUDIT

7. Information on the integrity and objectivity of the Office of the Auditor General and audit staff, and the nature and scope of the audit, were outlined in the Engagement Letter presented to the Board on 19 December 2018, and follow the requirements of the ISAs. We are not aware of any impairment to our independence as auditors.

AUDIT REPORT, ADJUSTMENTS AND MANAGEMENT REPRESENTATIONS

8. We issued an unmodified audit opinion on the financial statements.
9. A summary of misstatements corrected by management is attached in Appendix 1. The total net adjustments amounted to \$422,758. A summary of misstatements of \$6,239 that were uncorrected by management is attached in Appendix 2.
10. As part of the completion of our audit we have received written representations from management on aspects of the accounts and judgements and estimates made. Management has provide us with representations in respect of our financial statement audit.

SIGNIFICANT FINDINGS FROM THE AUDIT

SIGNIFICANT ACCOUNTING PRACTICES

11. We are responsible for providing our views about qualitative aspects of the Office's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Generally accepted accounting principles provide for the Office to make accounting estimates and judgments about accounting policies and financial statement disclosures. We are not aware of any areas where the significant accounting practices have changed from previous year or are not consistent with general industry practice. In addition we are not aware of any new or controversial accounting practices reflected in the Office's financial statements.
12. Details of any significant findings from the audit are included in Appendix 3.

MANAGEMENT'S JUDGMENTS AND ACCOUNTING ESTIMATES:

13. There were no matters which required management to make significant judgments or which required significant estimates except for the defined benefit liability.

GOING CONCERN DOUBTS:

14. As a result of our audit, we did not become aware of any material uncertainties related to events and conditions that may cast significant doubt on the Office's ability to continue as a going concern.

SIGNIFICANT DEFICIENCIES IN INTERNAL CONTROL:

15. We identified a number of significant matters relating to internal controls as part of our audit. These include:
 1. Waste of public money
 2. Value for money issues.
 3. Lack of policies
 4. Poor controls

Re-iteration from prior year

1. No approved training policies in place.
2. No approved traveling policies in place.

3. No tendering process for external contracts.

16. Details are included in Appendix 3.

FRAUD OR ILLEGAL ACTS:

17. Applicable auditing standards recognize that the primary responsibility for the prevention and detection of fraud and compliance with applicable laws and regulations rests with both those charged with governance of the entity and with management. It is important that management, with the oversight of those charged with governance; place a strong emphasis on fraud prevention, and fraud deterrence. They are also responsible for establishing and maintaining controls pertaining to the entity's objective of preparing financial statements that are presented fairly, in all material respects, in accordance with the applicable financial reporting framework and managing risks that may give rise to material misstatements in those financial statements. In exercising oversight responsibility, those charged with governance should consider the potential for management override of controls or other inappropriate influence over the financial reporting process.

18. As auditors, in planning and performing the audit, we are required to reduce audit risk to an acceptably low level, including the risk of undetected misstatements in the financial statements due to fraud. However, we cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.

19. No fraud or illegal acts came to our attention as a result of our audit.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE COURSE OF OUR AUDIT:

20. No serious difficulties were encountered in the performance of our audit.

DISAGREEMENTS WITH MANAGEMENT:

21. We have had no disagreements with management resulting from our audit.

ANY OTHER SIGNIFICANT MATTERS

22. None noted

ACKNOWLEDGEMENTS

23. We would like to express our thanks to the staff of the Utility Regulation and Competition Office for their help and assistance during the audit of this year's financial statements. This will enable us to provide an audit report within the agreed timetable.
24. If you would like to discuss the results of our audit or any other matters in further detail please feel free to call me at (345) 244-3201.

Yours sincerely,



Patrick O. Smith CPA, CFE
Acting Auditor General

APPENDIX 1 – SUMMARY OF ADJUSTED DIFFERENCES

Date	Account No	Name	Debit	Credit
31/12/2018	44013	Fuels Fees/Permits	286,700	
31/12/2018	43000	Other Income To reclassify the fees for SOL.		286,700
31/12/2018	58101	ICT Pension Contribution	11,000	
31/12/2018	21750	DB Pension Liability To adjust for the difference in the Actuarial Valuation from PSPB.		11,000
31/12/2018	58505	Doubtful Debt Expense	34,428	
31/12/2018	14100	Provision for Doubtful Debts To adjust the provision at year end.		34,428
31/12/2018	30000	Opening Bal Equity	74,784	
31/12/2018	15065	Plant and equipment Reversal of Fuel Tanks as a prior period adjustment.		74,784
31/12/2018	15066	Fixed asset Register- Accum Dep.	4,778	
31/12/2018	39000	Retained earnings Accum Dep. For the reversal of the fuel tanks.		4,778
31/12/2018	54946	Grants Contributions: Membership fees	6,082	
31/12/2018	50200	Travel & Substance Reclass IIC Membership fees from official travel.		6,082
31/12/2018	15066	Fixed asset register- Accum Dep.	4,986	
31/12/2018	60000	Depreciation expense Reversal of 2018 depreciation for fuel tanks.		4,986
Total			<u>422,758</u>	<u>422,758</u>

APPENDIX 2 – SUMMARY OF UNADJUSTED DIFFERENCES

Date	Account No	Name	Debit	Credit
31/12/2018	51311	Lease of Property	6,239	
31/12/2018	2000	Accounts Payable		6,239
		To post lease of property not included during the year.		
Total			<u>6,239</u>	<u>6,239</u>

APPENDIX 3 - INTERNAL CONTROL MATTERS & SIGNIFICANT FINDINGS

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>1. Waste of public money</p> <p>In August 2017, the Office entered into a 10-year rental agreement for new office premises which were due to be occupied from December 2017. During 2018 the Office paid a total of \$206,232 on rental for these premises. However, the Office has never occupied the premises and continues to be located at its present location where it continues to pay \$6,239 per month. At the time of our audit the Office was in the process of terminating the lease and negotiating a final settlement agreement for terminating the rental agreement. The lease commitment if the Office were to occupy the premises would be in the region of \$1,838,902. The commitment periods would be as follows:</p>	<p><u>Risk/Implication</u></p> <p>The Office wasted at least \$206,000 of public funds on paying rent for a property that it never inhabited There is likely to be a payment for terminating the contract in addition to rental costs in 2019. The Office has received no benefits from these payments and has wasted significant sums of public money.</p> <p><u>Recommendation</u></p> <p>The Office should terminate the lease agreement or occupy the building as soon as possible to limit the wastage of further public funds.</p> <p>The Office should ensure that it develops robust business cases and complies with Government policy prior to agreeing to any future contracts.</p>	<p>The Office entered into the lease with Smith Road Plaza with the expectation that funding for all sectors would be in place and therefore would be available to cover costs related to leasehold improvements, and that the leasehold improvements would be done in a timely manner at a reasonable price. As of the date of writing this response, the water sector remains unfunded, and the fuels sector did not receive funding until mid 2018. The Board of Directors made the decision to terminate the lease in August 2018 due to financial constraints which hindered the Office’s ability to cover the leasehold improvements. The lease was terminated in May 2019. The Office will use business cases for these types of activities in the future.</p>	<p>May 2019</p>

<table><tr><td>Less than 1 year</td><td>\$206,232</td></tr><tr><td>Greater than 1 year but less than 5 years</td><td>\$824,928</td></tr><tr><td>Greater than 5 years</td><td>\$,807,742</td></tr><tr><td>Total Future Commitment</td><td>\$1,838,902</td></tr></table>	Less than 1 year	\$206,232	Greater than 1 year but less than 5 years	\$824,928	Greater than 5 years	\$,807,742	Total Future Commitment	\$1,838,902		The Office should develop a strategy to help make more informed decisions about future office accommodation, so as to avoid further public waste.		
Less than 1 year	\$206,232											
Greater than 1 year but less than 5 years	\$824,928											
Greater than 5 years	\$,807,742											
Total Future Commitment	\$1,838,902											
2. Value for money issues <u>Travel</u> In in the previous financial year, we noted that there were no formal travel policies in place that clearly state how the expenditure for traveling should be managed. There is still not a policy in place. In the current year, travel and hospitality exceeded the budget by \$60K.	<u>Risk/Implication</u> There is the risk that travel costs are being incurred when they provide no business benefits or are much higher than they should be.	This Office agrees with the recommendation. An Official travel policy was drafted in July 2018. The Board of Directors placed an embargo on travel without their specific approval through the end of 2018. The Travel Policy was finalized and put into effect on October 25, 2019.	October 25, 2019									

<p><u>Hospitality</u></p> <p>During the audit it was noted that approximately \$21,000 was spent on hospitality. However, there is no hospitality policy in place that provides guidance on providing on what may be provided and how much money may be spent.</p>	<p><u>Risk/Implication</u></p> <p>There is a risk of an abuse of public funds as hospitality expenses may be incurred for activities that are not appropriate or amounts of hospitality that is excessive.</p> <p><u>Recommendation</u></p> <p>The Office should develop and implement policies for travel and hospitality that clearly states how the expenditure should be managed. In addition, the Office should do a business cases to justify travel and get approval in advance.</p>	<p>A formal hospitality policy will be prepared and completed by Q1 2020.</p>	<p>January 2020</p>
<p>3. Lack of policies</p> <p>Based on our review there is not a process in place in which to perform routine check on the validity or accuracy of data received from Uniregistry sales.</p>	<p><u>Risk/Implication</u></p> <p>The absence of a process in place to validate information received exposes the Office to inaccurate or incomplete information which could result in revenues being misstated.</p>	<p>The Office agrees with the recommendation and steps are being taken to implement a process to ensure the validity and accuracy of data received from Uniregistry.</p> <p>The Office will develop an internal control system during the 2019 financial</p>	<p>October 2019</p>

<p><u>Pay and benefits</u></p> <p>During the audit (5) senior employees received payments and benefits during the year without a proper performance assessment and evaluation process in place.</p>	<p>Recommendation</p> <p>We recommend that the Office develop an internal control system to check that the information received is complete, error free and accurate.</p> <p><u>Risk/Implication</u></p> <p>The lack of formal staff performance management system demonstrates a failure to set standards for job performance; holding employees accountable for set goals and objectives and providing the right training programs for employees that will aide in delivering the organizational priorities. The absence of a staff performance management system reduces the Office's ability to effectively demonstrate or have a clear supporting basis for employee promotions and other benefits awarded.</p> <p>Recommendation</p> <p>The Office should establish a formal</p>	<p>year.</p> <p>The Office agrees with the recommendation. A staff performance management system will be implemented during the 2020 financial year. The Office recognises the need to establish a proper staff performance management system. The <i>OfReg Reset Workshop</i> is planned for the 2nd and 3rd of December, with the aim to collectively set OfReg's direction; informed by values, vision, mission, legislation, policy, challenges and opportunities. The workshop will allow the team to reassess goals objectives and strategies of the Office and will cover informal and formal performance management. The Office is determined to employ a comprehensive and effective approach to addressing deficiencies which cannot be completed within the current financial year, inclusive of the review and</p>	<p>April 2020</p>
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	<p>performance management system. This will allow management personnel to establish guidelines for compensation increases; track employee strengths and weaknesses; identify the best candidates for promotion; offer feedback for improvements; and promote training programs. Meaningful performance assessments will help identify problems so they can be addressed.</p>	<p>evaluation of job descriptions.</p>	
<p>4. Poor controls</p> <p><u>Office letterhead</u></p> <p>It was noted during the audit that a consultant was using the Office letterhead to bill the Office.</p>	<p><u>Risk/Implication</u></p> <p>The use of the Office letterhead poses a risk as an Office letterhead is intended for official use only.</p> <p><u>Recommendation</u></p> <p>The Office should ensure that invoices and bills being paid are not on their letterhead.</p>	<p>The Office agrees with the recommendation and will ensure that consultants' invoices and bills are not placed on the Office's letterhead.</p>	<p>June 2019</p>
<p><u>Output billings</u></p> <p>The Office produces goods and services to Cabinet, with the budgeted amounts detailed and agreed to</p>	<p><u>Risk/Implication</u></p> <p>Amounts billed to Cabinet which agree to the approved budgetary</p>	<p>The Office agrees with the recommendation. During the current</p>	<p>June 2019</p>

by both parties annually in the Purchase Agreement. It was noted that amounts billed to Cabinet by the Office were based on the approved budgetary amount for the fiscal year and not on the actual cost of producing the goods and services.	<p>amounts do not factor in the cost of producing the goods and services. This system of billing could result in the over or under billing of the services produced for Cabinet.</p> <p>Recommendation</p> <p>It is recommended that outputs produced for Cabinet be measured using the input factors such as salary and other overheads to cost the outputs. This will result in the Office charging Cabinet the actual cost of producing the outputs.</p>	financial year, the Office will bill Cabinet based on the actual cost of producing the goods and services.	
Re-iteration from prior year			
<p>1. No approved telephone policies in place</p> <ul style="list-style-type: none"> During the audit we noted that there were no formal cellular phone policies in place that clearly states guidelines on how cellular 	<p>Implication</p> <p>A lack of formal telephone policies could result in the abuse of funds and misappropriation of assets. This could</p>	<p>Management Response</p> <p>A telephone policy addressing cellular phones was put into effect on October 25, 2019.</p>	October 25, 2019

phones assigned to employees should be used.	<p>have a negative impact on the Office.</p> <p>Recommendation</p> <p>The Office should ensure that a cellular phone policy is in place that gives clear guidelines on how phones assigned to employees should be managed.</p>		
<p>2. No approved training policies in place</p> <ul style="list-style-type: none"> During the audit we noted that there were no formal training policies in place that clearly states what the conditions are for training employees in addition to the nature of the training programs. 	<p>Implication</p> <p>A lack of formal training policies could result in the abuse of funds. This could have a negative impact on the Office.</p> <p>Recommendation</p> <p>The Office should ensure that a policy is in place that clearly states how the expenditure on training should be managed. In addition, the policy should clearly states guidelines on the type of training programs to be administered to employees.</p>	<p>Management Response</p> <p>A formal Training Policy was prepared and put into effect on October 25, 2019.</p>	<p>October 25, 2019</p>
<p>5. No tendering process for external contracts. Section 37 of the Public Management and Finance Law (2018 Revision).</p> <ul style="list-style-type: none"> During the audit it was noted that there was 	<p>Implication</p> <p>Failure to properly tender contracts or procure vendor services exposes the Office to a number of issues:</p>	<p>Management Response</p> <p>The contractors noted by the OAG were engaged by the former ICTA, with the exception of one contractor who was engaged in 2018 to provide marketing</p>	<p>December 2019</p>

<p>no formal tendering process for external contracts.</p> <ul style="list-style-type: none"> We noted that the Office currently has a procurement policy in place but did not see evidence of bids or quotes from different vendors. 	<ol style="list-style-type: none"> (1) The inability to properly determine that the distribution of public funds via competition for the use of public money is open, fair and free from potential bribery and nepotism. (2) Failure to ensure that no parties have an unfair advantage if separate, prior, closed-door negotiations for a contract. (3) Inability to properly conclude that they are obtaining the best value for money has been achieved. (4) Potential issues of undisclosed conflict of interest. (5) Employees can distort the requirements of contracts by claiming that the specifications call for a single source supplier, or non- 	<p>services. During 2018, all of the contractors noted by the OAG, with the exception of two are no longer used by the Office. The two contractors that are still engaged by the Office are providing Marketing and IT Services and the value of the contracts are below the \$50k threshold, however, the Office will re-assess the contracts to ensure that the procurement policy guidelines with respect to obtaining quotes are followed. All future contracts will abide by the requirements of the Procurement Policy.</p>	
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	<p>competitive procurements. This allows single tender action to be followed and competitive tendering to be disregarded. Single source procurement justifications may also be used to eliminate competition and steer contracts to a particular supplier. In some instances, potential fraud can be committed solely by the contractor based on poorly written specifications.</p> <p>Recommendation</p> <p>The Office should ensure that they adhere to the formal tendering process when engaging external parties that complies with the Public Management and Finance Law (2017 Revision).</p> <p>In addition, the Office should be complying with the Procurement Law 2016.</p>		
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