



**ELECTRICITY REGULATORY AUTHORITY OF THE
CAYMAN ISLANDS**

PAYROLL & EXPENDITURE AUDIT

Audit Report

February 2016

**INTERNAL AUDIT UNIT
CAYMAN ISLANDS GOVERNMENT**

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I. EXECUTIVE SUMMARY

Under the Public Management and Finance Law, the Internal Audit Unit (IAU) is required to review the management systems of all ministries, portfolios, statutory authorities and government companies.

In accordance with the 2015-2016 Audit Plan, we recently concluded a payroll and expenditure audit of the Electricity Regulatory Authority of the Cayman Islands (ERA).

Conclusion

With the exception of the finding noted in this report, the Internal Audit Unit can provide reasonable assurance that the payroll and expenditure management systems within the Electricity Regulatory Authority are adequate to support the achievement of its objectives. We have made recommendations for improvement in the area where the deficiency was noted, to which the ERA's management has agreed and committed to the implementation of the corrective action plan.

Deloris E. Gordon
Director, Internal Audit Unit

February 25, 2016



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II. INTRODUCTION

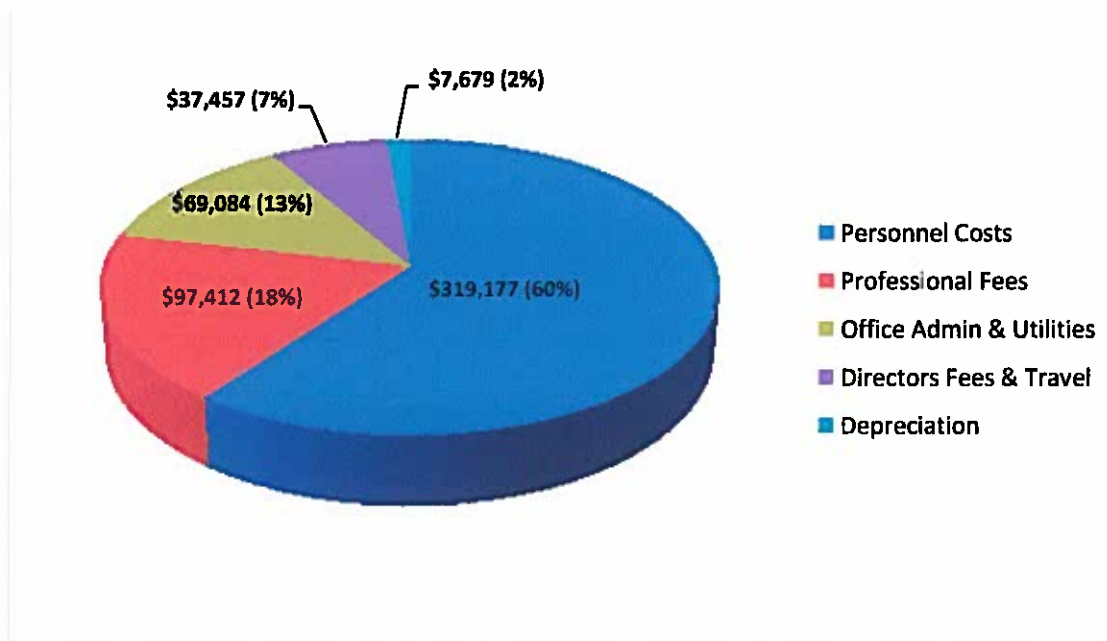
Background

The ERA was established in accordance with the Electricity Regulatory Authority Law (2005 Revision). The Authority is the regulator for the electricity sector in the Cayman Islands. The ERA carries out its functions with an aim to protect the interests of consumers and licensees, as well as the security and public interests of the Island as a whole. Key responsibilities of the Authority include monitoring licenses granted, ensuring that reporting requirements under those licenses are adhered to, approving capital expenditures and pass-through charges, and ensuring the accuracy and timeliness of license fee submissions from licensees.

The ERA's only office is located on West Bay Road, Grand Cayman, where a staff complement of 3, made up of a Managing Director, a Deputy Managing Director and an Analyst, carry out the duties of the Authority in accordance with the ERA Law. The Managing Director, who is employed on a part-time basis, and the Deputy Managing Director are responsible for the day-to-day operations of the Authority, including the performance of financial and administrative duties. In addition, the ERA is governed by a Board of Directors, appointed by the Governor in Cabinet, who are responsible for policy and general administration of the affairs and business of the ERA.

Given the organizational capacity of the Authority, the establishment of effective internal controls, including appropriate segregation of duties, presents some difficulty. However, to mitigate the risks within the expenditure management processes, the ERA has implemented compensating controls, one of which requires the Board, by majority vote, to approve expenditures in excess of \$3,000.

For FY2014/15 the Authority budgeted \$658,400 for its operating expenses. As at June 30, 2015, actual operating expenses amounted to \$530,809, the breakdown of which follows:





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As shown above, the ERA's largest expense during the period was personnel cost, accounting for 60% of its expenditure budget. Following is a breakdown of those costs:

Type of Expense	Amount	%
Salaries	\$251,333	78.74%
Work Permit Fees	\$27,927	8.75%
Pensions	\$22,718	7.12%
Health Insurance	\$13,799	4.32%
Vehicle Allowance	\$3,000	0.94%
Employee Training	\$400	0.13%
Total:	\$319,177	100%

Accounting System/Software

The ERA utilizes QuickBooks to process and record their expenditure and payroll transactions.

Audit Objectives and Scope

During this audit, we examined the payroll and expenditure management system at the Electricity Regulatory Authority of the Cayman Islands. The specific objectives of the audit were to determine whether:

- The payroll and expenditure management systems were adequate to ensure the accuracy and timeliness of transactions;
- Adequate controls were in place to ensure that expenditure and payroll transactions were valid and authorized;
- Relevant contracts/agreements were in place to support employment and general expenditures;
- Goods and services that were ordered and paid for were received during the financial year; and
- Transactions were in compliance with Laws, Regulations, policies and procedures, and best practices.

The audit examined samples which were selected from an overall population of payroll and expenditure transactions that occurred between July 1, 2014 and June 30, 2015. Where applicable, some sampled transactions that originated in FY2014/15 required the review of subsequent transactions/documents that occurred/were prepared in FY2015/16.

Audit Methodology

The audit methodology involved understanding and documenting the processes under review and the internal controls governing those processes, performing risk assessment to identify and evaluate potential risks and key controls, and developing an audit program to test whether those controls were operating as intended.



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Our audit conclusion is therefore based on our overall assessment of the control procedures against the audit objectives.

Audit Criteria

The management systems and internal controls in place were measured against the following:

- Public Management and Finance Law;
- Financial Regulations;
- Electricity Regulatory Authority Law;
- Health Insurance Law;
- National Pensions Law;
- Labour Law; and
- Generally accepted accounting principles and best business practices.

In addition to evaluating the internal control activities, other fundamentals of an effective internal control framework were also assessed as defined by the COSO Model, which identifies other elements of good internal control as:

- The **control environment**, which is the foundation for the effectiveness of all the other internal control components and reflects management's commitment and attitude towards the control structure;
- Ongoing **risk assessment**, which should be performed by management and involves identifying and analyzing the significance and likelihood of potential risks that may adversely affect the entity's ability to meet its objectives;
- **Information and communication** systems ensure that pertinent information is identified, captured and communicated in a form and within a timeframe that enable the achievement of objectives; and,
- Ongoing **monitoring and review** of activities and processes is necessary in order to assess their performance over time and against pre-determined requirements.



III. AUDIT REPORT

1. Inadequate Human Resources Procedures

Section 6 (1) of the Labour Law (2011 Revision) states that every employer who enters into a contract of employment with an employee shall "within ten working days of entering into such contract, furnish the employee with a written statement of his conditions of employment in accordance with subsection (2)".

Further, Section 6 (3) of the Labour Law (2011 Revision) states that "whenever, subsequent to the giving of a statement under subsection (1) or (2), any material change is made in any of the terms of employment set out in the statement, the employer shall forthwith furnish the employee with an amended statement embodying the change". Valid methods of recording such changes to the conditions of employment include written amendments (e.g. memos, letters) or revised contracts of employment.

During the audit, we noted that, while the [REDACTED] was provided a Contract of Service at the commencement of his employment, that contract was not finalized and signed by all relevant parties until 19 months after his start date (August 2013 to March 2015).

When we queried the delay in formalizing the contract, it was explained that some provisions in the original document, such as vacation leave, needed legal clarification prior to finalization.

Additionally, during our review we noted that material salary increments of 19% and 52% were awarded to the [REDACTED] and the [REDACTED] respectively. However, despite being approved by the Board (as evidenced in the minutes of meeting), revised contracts of employment or written amendments were not prepared and furnished to the concerned employees as required under the Law.

When we queried the lack of written amendments, management explained that they assumed the Minutes of the Board Meeting would serve as sufficient documentation to support the salary increases. Further, it was stated that the new amounts were reflected on the pay slips that are provided to employees monthly.

Based on these findings, we concluded that the HR practices at the ERA are not sufficient to ensure compliance with Section 6 of the Labour Law (2011 Revision). Although the Contract of Service for the [REDACTED] has now been formalized, the initial absence of a signed contract documenting the terms of agreement represented a violation of the Law and exposed the ERA to the risk of disputes or claims against the entity.

Additionally, as it relates to the lack of written amendments, the ERA remains in breach of the Law until such time that the amendments are created and provided to the concerned employees.



Recommendation

The Managing Director should ensure that:

1. Going forward, all instances where the ERA enters into employment arrangements, such arrangements are evidenced by duly signed contracts that are finalized prior to the start of the employment term;
2. Written amendments outlining the material changes in remuneration for the [REDACTED] and the [REDACTED] are prepared and disseminated to the concerned employees. Additionally, a copy of each amendment should be placed on the respective personnel files for review and audit purposes;
3. The ERA implements procedures in the area of Human Resources in order to assure consistent compliance with all aspects of the Labour Law.

Management's Response

Management agrees with the recommendations and undertakes to implement them forthwith.

Implementation Date: *February 28, 2016*