January 17, 2003

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Internal Audit Report

Wire and EDI Payments
Internal Controls

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A significant portion of BC Hydro’s cash disbursements are made by wire transfers and electronic data interchange (EDI). During the test period April 2002 to October 2002, 89% of the $3.5 billion in trade and debt payments were disbursed by wire or EDI.

Our audit identified a serious control deficiency in the Property Tax wire payment system. One manager has an inappropriate concentration of duties. This includes access to property tax payable records, the ability to create and modify vendor bank accounts to which payments are made, sole responsibility for input and authorization of the wire payment, and receipt and review of the bank reports itemizing funds disbursed. This provides the opportunity to conceal a misappropriation of funds. As a result, additional work was done. Five years of payments were reviewed to ensure that property tax liabilities were disbursed only to one account and that no unusual payee names were listed on the bank reports. No unusual items were noted. Annual payments under this system are approximately $137 million, covering 2,200 assessments.

The wire payment system used in Properties is not backed up. Processing requirements for the 2,200 property tax payments are very tight, falling within a two month window. As a result, a loss of data during this period could impact the ability to meet payment deadlines subjecting BC Hydro to interest and penalties.

With the exception of the above noted deficiencies, the internal controls over the wire and EDI disbursements are good.
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1. **Background**

- Four departments within the organization have roles and responsibilities for processing payments as follows:
  - **Treasury**
  - **Accounts Payable**
  - **Property Tax**
  - **Financial Accounting & Compliance**

- **Customers / Suppliers**
  - Provincial Govt
  - Treasury
  - Provincial Govt

- **Wire System**
  - **Esqwire**
    - Originate & process wire payments
    - Process Property Tax & First Nations payments
    - File supporting documents
    - Originate & process EDI payments
    - Record wire payments
    - Record bank transfers
    - Review bank account activity
    - Perform bank reconciliations
  - **Esqwire**
    - Treasury
    - Other BCH Depts
    - Trade Suppliers
  - **Royal/EFT**
    - Provincial Govt
    - Municipalities
    - Indian Bands
    - Regional Districts
    - Treasury & Property Tax & other BC Hydro Depts that do not process trade invoices thru Accounts Payable

- EDI and wire payments can be made from the following three systems:
  - ESQwire, a system from Bank of Montreal utilized for treasury and accounts payable wire disbursements;
  - Royal bank software utilized for property tax disbursements; and
  - EDI payments through the Peoplesoft accounts payable module.

- Financial Accounting and Compliance records all entries not processed through Peoplesoft.
2. Audit Objective and Scope

Objective

- Provide assurance that internal controls over funds transferred by wire and Electronic Data Interchange (EDI) are appropriate to ensure transactions are valid, authorized, accurate, complete and timely.

Scope

- For the period April 2002 to October 2002, review the key business risks, processes, procedures and controls which comprise the following key components:
  - Wire disbursements using Esquire for treasury and payables.
  - Wire disbursements using the Royal Bank system for property taxes.
  - Electronic Data Interface disbursements using Peoplesoft for trade payables.
  - Reporting and reconciliation processes.

- The audit included testing of transactions, review of key controls, analysis using data extraction tools, review of supporting documentation, and discussion with employees and management.

- Powerex wire payments for energy and non-energy transactions were excluded from this audit’s scope since they were covered in a separate 2002 audit.
3a. **Wire Payments - Treasury & Accounts Payable**

- Esquire is used for the majority of wire disbursements, approximately $2.6 billion for the period tested. Wire requests primarily originate from Treasury for debt and interest payments, and from other areas for non-trade payments. The disbursements are then forwarded to Financial Accounting to record the transactions.

- We found that the control environment for Esquire wire disbursements is good. We noted that adequate segregation of duties exists and disbursements are authorized using electronic approvals based on prudent assignment of system privileges.

- Based on our discussions and review, individuals are aware of their duties and responsibilities within their own department.

- Wire payment requests are reviewed by Accounts Payable for authorization prior to payment. Our testing identified all wire disbursements were accurate, as compared to the source documentation, and were appropriately approved and authorized.

- Based on NCS information, the ESQwire wire transfer database is properly backed up.

- There are processes in place for the system to check for duplicate payments. Treasury compares pending wire payments to Provincial Government reports which would identify a duplicate Government payment and assign unique payment identification to flag possible duplicates. For Accounts Payable, Peoplesoft has online enquiry abilities to detect possible duplicate payments. We were told this inquiry is done, but no documentation is retained to support that the inquiry was executed.

- We tested timeliness of wire disbursements and found that the disbursements were processed on a timely basis, normally daily. We also tested the timeliness of the financial recording of the wire payment and found that the corresponding financial entries are generally processed by Financial Accounting within two days of the disbursement.
### 3a. Wire Payments - Treasury & Accounts Payable

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<th>Recommendations</th>
<th>Management Action Plans</th>
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<tbody>
<tr>
<td>Accounts Payable should file documentation supporting the execution of the duplicate payment check.</td>
<td>Management agrees. Documentation supporting duplicate payment checks for wires will be retained. Expected completion date: February 1, 2003.</td>
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</table>
3b. Wire Payments - Property Tax

- The Properties Department use their own wire transfer system with the Royal Bank. This system is utilized as it is more flexible and can connect with more financial locations than the Esquire system.

- Properties process approximately 2,200 property tax notices within a two month time period. The annual value of payments made is approximately $137M.

- Staff from Properties review and input the individual assessment notices into a customized system called “Property Acquisition and Tax System” (PATS). PATS aggregates the notices by the various cities and districts and provides a report of the total disbursement required to meet the property tax obligation.

- We tested a sample of wire disbursements and found them to be accurate, as compared to the supporting documentation in PATS. We noted that the disbursements were supported by tax notices, that records were well organized, and evidence of review existed.

- The property tax payments also include payments to First Nations groups for property rights. Authorization is based on signed contracts with various First Nations. Our tests of First Nations payments indicate that they are authorized and accurate as compared to supporting documentation.

- Authorization for property tax payments under the Corporate Policy Statement (CPS) is unclear and outdated. The CPS identifies that the Senior VP and CFO have authority to approve $75M in property taxes. Property tax management has stated that this policy has been interpreted to apply to payments to individual municipalities/government bodies. However, given that the aggregate payments on property taxes are currently in the $140M range, the majority of which is paid within a three day window, this approval level should be clarified. In addition, we noted that authority levels for approving property taxes have been delegated to individuals without properly recording the delegated levels in the system that tracks employee approval authority.

- Properties informs treasury and financial accounting of the aggregate property tax liability which is transferred into a bank account for wire disbursement. Financial Accounting records the property tax entry, and ensures that the aggregate disbursements reconcile to the aggregate transfer.
3b. Wire Payments - Property Tax

- A significant control deficiency in the Property Tax payment process was noted. One manager has access to PATS, allowing adjustment of the property tax payable amount. In addition, the same manager handles all duties related to the Royal Bank wire system, including the input of the disbursement amounts, creation and modification of the receiving bank accounts, release of the wire payments, and receipt of bank reports itemizing the payees receiving the disbursements.

- As this concentration of duties provides the opportunity to misappropriate funds, additional testing was undertaken. For 5 years of bank reports we confirmed that the payees to which funds were wired were identical to the amounts stated on the PATS system. A unique vendor or split payment would indicate a diversion of funds. No unusual items during the period tested were identified.

- The wire payment system used in Properties is not backed up. The system and data are retained on a non-shared drive of the managers office computer. Processing requirements for the 2,200 property tax payments are very tight, falling within a two month window. As a result, a loss of data or the computer during this period could impact the ability to meet payment deadlines subjecting BC Hydro to interest and penalties.

- Annual correspondence exists that document changes made to the receiving bank accounts. However, no system log or report was available to identify recent changes.
Recommendations and Management Action Plans

Recommendations

- Review the roles and responsibilities of staff processing property tax payments at a minimum:
  - Staff with access to the wire disbursement system should have read only access to the data entry control system (PATS).
  - The creation and modification of receiving bank accounts should be segregated. Management should review changes made. Furthermore a system report documenting changes made should be generated to document approval and identify any errors.

- Ensure proper data backup for the Property Tax wire payment system.

- Review the approval levels for property taxes. Currently the Senior VP and CFO has authority to approve $75M in property taxes. Given the aggregate expenditure of approximately $140M we recommend that the entire transfer be approved by the Senior VP and CFO.

Management Action Plans

- Management agrees. Recommendation accepted and will be implemented prior to the 2003 Property Tax payment cycle.

- Management agrees. Backup procedure recommendation accepted and will be implemented prior to the 2003 Property Tax Payment cycle.

- Management agrees. Corporate Finance will review the Corporate Approving Authority procedure to ensure current business requirements are being met. Expected completion: June 2003.
4. Electronic Data Interchange Payments

- Generally, the control environment for processing invoices that involve EDI payments is good. Accounts payable staff use the Peoplesoft A/P system to process invoices which are subsequently flagged for EDI disbursement. Prior to processing payments, Accounts Payable personnel confirm the invoice is approved by a manager, and that the manager has appropriate authorization. We noted that:
  - Adequate controls exist for establishing the receiving account for EDI disbursements.
  - Roles and responsibilities are defined and understood.
  - Adequate segregation of duties exists.

- We tested a number of EDI disbursements and found that all payments were accurate as compared to their supporting documentation, were appropriately authorized, disbursed on a timely basis, and entered in the applicable accounting period.

- We tested the duplicate payment controls that exist for EDI payments and noted:
  - Evidence of the execution of the control was incomplete. Reports were not available to provide evidence that the “possible duplicate payment” reports had been run. Staff indicated that they did not retain reports showing no “possible duplicates”.
  - The effectiveness of the control is compromised by allowing blanks to be entered in the invoice number field. This creates unique invoice numbers which would not be identified as a duplicate payment.
## Recommendations and Management Action Plans

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<tr>
<td>Ensure that the duplicate payment control is completed for each accounts payable cycle by filing all reports, including blank reports. Alternatively, produce alternative accountability documents that indicate the date the report was reviewed and show a check for sequential consistency.</td>
<td>Recommendation accepted and will be implemented by February 1, 2003.</td>
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<tr>
<td>Consider enhancing the Peoplesoft A/P system edits to prevent data entry of blank spaces into the invoice number field.</td>
<td>Recommendation accepted and will be implemented by June 30, 2003, providing no further program modification freezes are planned.</td>
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5. Reconciliation & Reporting

- The Financial Accounting and Compliance (FAC) Group prepare journal entries and perform bank reconciliations for various wire transactions and EDI bank accounts.

- FAC reviews copies of all wire payment requisitions for appropriate recording and does the recording for requisitions not processed through PeopleSoft. They also review all wire payment activity via on-line bank reports and evidence their review.

- Our tests indicated that journal entries were accurate as compared to source documents and bank reconciliations were also prepared and reviewed by management. No internal control exceptions were found.