



UTILITY REGULATION AND COMPETITION OFFICE

Report to those charged with governance on the 2023 audit

27 May 2024

***To help the public service
spend wisely***

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REPORT TO THOSE CHARGED WITH GOVERNANCE

INTRODUCTION

1. We have completed our audit of the year ended 31 December 2023 financial statements of the Utility Regulation and Competition Office (“OfReg”). International Standards on Auditing (ISAs) require that we communicate certain matters to those charged with governance of the Utilities Regulations and Competition 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 that we consider are worthy of drawing to your attention.
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 Act (2021 Revision), 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. While we have no responsibility to perform any audit work on other information, including forward looking statements, containing audited financial statements, we will read the other information contained in OfReg's annual report to consider whether such information is materially inconsistent with information appearing in the financial statements or our knowledge of the operations of the OfReg.

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 Chief Executive Officer and signed on 13th September 2023 and follow the requirements of the ISAs. We are not aware of any impairment to our independence as auditors.

AUDIT REPORT, ADJUSTMENTS AND MANAGEMENT REPRESENTATION

8. We issued an unmodified auditor's report on the financial statements for the year ended 31 December 2023.
9. A summary of misstatements corrected by management is attached in Appendix 1. There are no uncorrected misstatements identified by us during the audit that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
10. As part of the completion of our audit we obtained written representations from management on aspects of the accounts and judgments and estimates made. Management provided us with written representations dated 24 April 2024 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 OfReg's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Generally accepted accounting principles provide for OfReg 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. We are not aware of any new or controversial accounting practices reflected in OfReg's financial statements.

MANAGEMENT'S JUDGMENTS AND ACCOUNTING ESTIMATES

12. Management have made significant judgements and estimates with regard to the following financial statement items:

- Depreciation of Property, Plant and Equipment
- Amortization of intangible assets
- Allowances for credit losses
- Post-retirement health care liability
- Post-retirement past service pension liability

GOING CONCERN DOUBTS

13. 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 OfReg's ability to continue as a going concern.

SIGNIFICANT AND OTHER DEFICIENCIES IN INTERNAL CONTROL

14. We identified a number of significant matters relating to internal controls as part of our audit. Details are included in Appendix 2 along with management's response.

15. There are no other internal control deficiencies are reported separately to management.

FRAUD OR ILLEGAL ACTS

16. Applicable auditing standards recognize that the primary responsibility for the prevention and detection of fraud and compliance with applicable acts 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 OfReg'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.

17. 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.
18. No fraud or illegal acts came to our attention as a result of our audit, except for what has been disclosed by management.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE COURSE OF OUR AUDIT

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

DISAGREEMENTS WITH MANAGEMENT

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

ANY OTHER SIGNIFICANT MATTERS

21. There were no other significant matters noted during the audit.

ACKNOWLEDGEMENTS

22. We would like to express our thanks to the staff of OfReg for their help and assistance during the audit of this year's financial statements, which enabled us to complete the audit prior to the statutory timeline.

Yours sincerely,



Sue Winspear, CPFA
Auditor General

APPENDIX 1 – SUMMARY OF ADJUSTED DIFFERENCES

Number	Date	Name	Account No	Debit	Credit
10	31/12/2023	Accrued Expenses	20500	309,138.00	
10	31/12/2023	Accrued Expenses	20500	38,496.49	
10	31/12/2023	Payroll Expenses	50011		-309,138.00
10	31/12/2023	Pension Contribution	58101		-38,496.49
		Reversal of COLA adjustment accruals			
11	31/12/2023	Provision for Doubtful Accounts	14100		-122,331.82
11	31/12/2023	Doubtful Debt Expense	58505	122,331.82	
		Provision for Doubtful debts 2023			
12	31/12/2023	Accrued Expenses	20500		-40,000.00
12	31/12/2023	Legal Service Fee	54507	40,000.00	
		Provision for legal costs			
13	31/12/2023	Accrued Expenses	20500		-6,547.80
13	31/12/2023	Consultant's Fees	50110	6,547.80	
		Accrual of consultant fees \$6,547.80			
14	31/12/2023	DB Pension Liability	21750		-3,000.00
14	31/12/2023	Acc. Other Comprehensive Income	35000	26,000.00	
14	31/12/2023	Past Service DB Pension Expense	58102		-23,000.00
		Post retirement pension liability actuarial adjustment			
15	31/12/2023	Post Ret. Health Care Liability	28000	1,000.00	
15	31/12/2023	Post Ret. Health Care Liability	28000		-6,500.00
15	31/12/2023	Post Ret. Health Care Liability	28000	321,000.00	
15	31/12/2023	Acc. Other Comprehensive Income	35000		-321,000.00
15	31/12/2023	Post-Retirement Health Costs	50115		-1,000.00
15	31/12/2023	Post-Retirement Health Costs	50115	6,500.00	
		Post-retirement healthcare liability adjustment			
16	31/12/2023	Prior Period Adjustments	39500		-29,515.12
16	31/12/2023	Doubtful Debt Expense	58505	29,515.12	
		To adjust 2022 provision - implementation of IPSAS 41			
				900,529.23	-900,529.23

APPENDIX 2 - INTERNAL CONTROL MATTERS & SIGNIFICANT FINDINGS

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>1. <u>Noncompliance with the Procurement Policy</u></p> <p>i) Non-tendering of IT hardware and software maintenance services.</p> <p>On 1 February 2017, Ofreg signed a contract with an IT provider for the provision of Hardware and software support, including maintenance & backup services, at a minimum monthly rate of \$3,750, equivalent to \$45,000 per year without a contract end date. However, Ofreg has not tendered the services since 2017. So far, the contract value over the five years and 9 months is about \$265,000 (\$45,000 at 5.9 years).</p> <p>ii) No request for quotations for IT services above \$10,000 but less than \$100K.</p> <p>On 12 February 2021, Ofreg signed a contract with an IT provider for the provision of Managed services at \$1,200 per month, an average of \$14,400 per</p>	<p>Risk/Implication</p> <ol style="list-style-type: none"> In the absence of a competitive bidding process, Ofreg may not achieve value for money. The absence of valid contracts may result in unmitigated risks should any legal disputes arise. <p>Recommendation</p> <ol style="list-style-type: none"> Management should ensure competitive bidding for goods and services procured to maximize resources. This will ensure that Ofreg obtains value for money for its goods and services procured. Ofreg should sign contracts with the storage space service providers as 	<p>Non-tendering of IT hardware and software maintenance services.</p> <p>Corporate IT Services ceased in mid-Oct 2023. On September 11, 2023, we employed a full-time IT Manager who immediately began ensuring that our procurement policy was strictly adhered to. We expect minimal to no departures from the established procurement policy going forward.</p> <p>Regarding the contract with Kirk Office, we are in the midst of migrating our email and storage services. This is expected to be fully implemented in July/August 2024. At that time this new migration will change the professional managed service requirement. We will be requesting updated quotes from the required 3 vendors at that time. As</p>	<p>September 11, 2023</p> <p>On or before August 31, 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>year. The agreement was limited to 6 months; however, Ofreg continued with the contract for over two years without enabling competition through a request for at least three quotations from reputable service providers to assess the competitiveness of price and services offered contrary to Ofreg procurement policies and procedures manual pages 9 & 10. So far, the contract value at the end of 2023 is approximately \$41,760 (2.9 years at \$14,400 per year).</p> <p>iii) Lack of valid contracts for the following services</p> <ul style="list-style-type: none"> Storage license agreement signed on 9th December 2021, expired on 28 February 2022 but has not been renewed. Ofreg had no contract with the vendor for the use of the A20 Highgrove business park during the year. 	<p>soon as possible to formalize the existing business arrangement.</p>	<p>such, we expect full compliance with the procurement policy.</p> <p>We have recently secured the required contract with Rousseau. Please see a copy attached.</p>	<p>April 10, 2024</p>
<p>2. Understaffing in regulatory areas</p> <p>Ofreg lacks staff in key regulatory areas. For example, the following key posts</p>	<p>Risk/Implication</p> <p>Understaffing may lead to inadequate oversight of the</p>	<p>The recruitment of staff in specialist areas has proved difficult for a number of reasons. Firstly, having to</p>	<p>By December 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>were still vacant: Director of Economics, Deputy Director Water, and Deputy Director ICT. Per Board minutes, Management attributed the recruitment delays to budget constraints, which hindered the recruitment of potential candidates at market rates.</p>	<p>regulatory areas. There is a risk that regulated entities may not comply with established regulations due to inadequate oversight.</p> <p>Recommendation</p> <p>Management should expedite the recruitment of staff in key positions to ensure effective oversight of regulated areas.</p>	<p>use PoCS Scales and Job Evaluated graded posts makes OfReg uncompetitive in the international job market. Secondly, the lack of school places for expatriate children will deter persons with families from applying. Thirdly the high cost of living and high cost of rental accommodation.</p> <p>The Director of Economics has been hired pending getting places in school for his children.</p> <p>The Deputy Director of Water position has been advertised 3 times without success. A consultant has been engaged to fill the gap.</p> <p>We have developed an Upskilling Management Scheme to fill the vacant post of Deputy Director of Information, this means we second people into that position for a six-month period and enroll them in ILM Level 3, so they get a mixture of</p>	

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
		<p>experience and academic training. This part of succession planning.</p> <p>In addition, we are working with the Ministry to recruit above the job evaluated grade.</p>	
<p>3. Lack of a risk management policy</p> <p>OfReg did not have a risk management policy during the period under review. We have made a similar finding over the past four years.</p> <p>It is our understanding that in the prior year, Management contracted a company to develop an Enterprise Risk Management (ERM) strategy to manage risk. However, as of 31 December 2023, the strategy had not yet been completed.</p> <p>An effective risk management system provides assurance that risks to the entity have been identified, assessed/analyzed, have a detailed response/prioritization, monitored, and controlled.</p>	<p>Risk/Implication</p> <p>Without a formal risk management policy, OfReg may not consider the various potential risks or events before they occur. In addition, OfReg may not have established procedures to avoid potential threats to minimize the impact should they occur.</p> <p>Recommendation</p> <p>OfReg should expedite the development of a formal risk management policy that allows it to identify, assess, and manage its risks.</p>	<p>We are in the final stages of implementation. The policy framework and risk registers were reviewed by the Risk and Audit committee in April 2024. We are now awaiting the board's final approval. An action plan will be established to deal with those areas that are high risk.</p>	<p>June 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>4. Under collection of Regulatory fees</p> <ul style="list-style-type: none"> Information and Communications Technology (ICT) regulatory fees are billed according to the budget for the sector of \$1.8 million; however, only \$1.52 million was collected, resulting in uncollected revenue of \$0.28M for the 2023 financial year. The shortfall is mainly due to a stipulation in the license of a dominant licensee which caps the maximum amount of regulatory fees to be charged during any given year at \$600k. Ofreg missed its Water sector revenue target of \$1.1 million by \$0.36 million due to delays in approving the statutory fees mechanism for sharing water sector royalties. The cabinet has not yet approved the amendments to the Water Authority regulations, which would allow the distribution of royalties based on water consumption. 	<p>Risk/Implication</p> <p>There is a risk that OfReg may not collect enough revenue to cover its expenses or build its equity reserves.</p> <p>Recommendation</p> <ul style="list-style-type: none"> Management should ensure budget targets are achievable to cover regulatory expenses. Management should liaise with the Cabinet to expedite the approval of the statutory fee mechanism for sharing water sector royalties. 	<p>As in prior years - the majority of the shortfall is due to a stipulation in the license of a dominant licensee, which caps the maximum amount of regulatory fees to be charged during any given year at \$600k. This cap was reached during the year, and it is the Office's policy not to recover the amount in excess of the cap from other licensees. The Office believes that this is a fair practice. While the regulatory fee amount recovered from licensees is below the costs incurred by the ICT Sector, the sector was able to offset the shortfall with other revenue streams for the sector. During the year, the sector delivered a surplus, and the Office has sufficient reserves on hand. The Office monitors expenses closely during the year to ensure that there is sufficient revenue on hand, therefore there was no need to place additional burden on the ICT sector for higher regulatory fees.</p>	<p>To be determined.</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
		Regarding approving the statutory fee mechanism for sharing water sector royalties, we are waiting for the Cabinet to complete the awarding of concessions to the Cayman Water Company (CWC). The award is expected to be granted by the end of August 2024. We are also in discussions with The Water Authority about the Water Sector (Licences and Fees) Regulations, which we are currently constructing. We expect the regulations to be finalized and to implement the new statutory fee mechanism by December 2024.	August 2024 December 2024
<p>5. Value for money for Outputs funding</p> <p>Per the purchase agreement, we tested the delivery of outputs and noted that some output measures were not fully achieved. For example, under URCO 11—Economic Regulations and Monitoring of the Fuel Sector, Bi-annual market review reports aimed at assessing the adequacy of relations and the state of competition in</p>	<p>Risk/Implication</p> <p>Non-implementation of planned outputs may hinder the effective use of output funding.</p>	<p>In 2021, the Office commissioned a market review, namely, the Cayman Islands Fuel Sector – Fuel Market Definition and Economic & Regulatory Assessment Study. The consultant firm, Economics Partners Limited, conducted the review. They were selected through a competitive bidding process and were</p>	<p>July 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>the relevant markets were not prepared. Therefore, we could not determine whether Ofreg achieved value for money for the output funding it received from the Cabinet in 2023.</p>	<p>Recommendation</p> <p>OfReg should ensure planned outputs per purchase agreement have achieved value for money.</p>	<p>awarded an agreement valued at \$154,860.00. The market review covered a market definition and assessment of 13 fuel product markets. The consultant indicated that the market reviews are typically done every 3 to 5 years, which is in keeping with Competition Economics principles. As such, the Office plans to conduct the next market review in 2025.</p> <p>Given that it is more appropriate to conduct these reviews every 3 to 5 years, the number of outputs recorded on the purchase agreement for 2023 should have been lowered by the Office. Looking ahead, our CEO will request an amendment of the number of outputs on our 2024-2025 purchase agreement from 2-6 to 0 in 2024 and 1 in 2025.</p>	

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>6. Delays in the issuance of fuel permit licenses</p> <p>From the review of Deferred revenue, we noted that Oreg had unearned revenue of \$84K in 2023 and \$70K in 2022 due to unissued permits; hence, revenue could not be recognised as earned. The delays in issuing fuel permits were attributed to staffing gaps, as the chief fuel inspection officer who was responsible for approving fuel permits left in January 2023. During the year, the role of the chief fuel inspection officer was taken over by the Director of information on a temporary basis; hence, it took time to resolve the permit issuance backlog for 2022 and 2023.</p>	<p>Risk/Implication</p> <p>Delays in the issuance of permits may hinder the enforcement of fuel industry regulations, which could hinder competition and cost-effective delivery of services by the regulated entities.</p> <p>Recommendation</p> <p>Oreg should expedite the recruitment of a qualified fuel inspector to ensure adequate review and timely approval of fuel permit applications.</p>	<p>We have commenced the recruitment process for two positions. The first candidate has been secured temporarily to assist with administrative tasks and clear the backlog of unissued permits. Their start date is set for Jun 3, 2024.</p> <p>We expect to hire the second candidate by Aug 1, 2024. This person will be employed as a full-time fuel inspector and assist with any remaining backlog upon joining. Their start date is expected to be or before August 1, 2024.</p> <p>In addition, fuel permit authorizations have been delegated to the Deputy Chief Fuels Inspectors. We expect to begin advertising for a full time Chief Fuels Inspector shortly.</p>	<p>June 3, 2024</p> <p>August 1, 2024</p> <p>December 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>7. Information Technology (IT) governance and management</p> <p>IT governance involves putting policies and procedures in place that are used as a guide for accessing IT and/or instruction for employees and the board. These policies and procedures should ensure that IT systems support the business objectives and risks.</p> <p>OfReg did not have a formal IT governance policy during the 2023 financial year, and management does not have formal oversight of IT outcomes and risks.</p>	<p>Risk/Implication</p> <p>Inadequate oversight of IT controls could result in misalignment of IT strategy with the corporate strategy, and un-managed IT risks.</p> <p>Recommendation</p> <p>OfReg should put into place an IT governance policy, and management and the board should oversee its implementation.</p>	<p>Work has begun on the framework of an IT governance policy. We expect the implementation plan will be rolled out during 2024. In addition, the Board has established an IT Committee to oversee the implementation of the plan.</p>	<p>December 2024</p>
<p>8. Lack of SOC II reports and bridge letters</p> <p>Ofreg did not have Service Organisations Controls (SOC) audit reports for the applications and services provided by third-party providers during the audit.</p> <p>Ofreg relies on Intuit (QuickBooks) and Formstack internal controls to ensure the necessary security measures are in place. A</p>	<p>Risk/Implication</p> <p>Controls in place relating to outsourced services could be significantly deficient.</p> <p>Recommendation</p> <p>Ofreg should obtain SOC audit reports from service providers (and relevant bridge letters) in a</p>	<p>As recommended, we will request regular SOC II reports from Intuit and Formstack and work to mitigate control risks that will be identified.</p>	<p>July 2024</p>

Observation	Risk/Implication and Recommendation	Management Response	Implementation Date
<p>SOC report would detail control risks in the third-party systems and any expected controls to be implemented by end-users to mitigate the significant risks. However, at the time of the audit, Ofreg had neither the SOC reports for QuickBooks nor Formstack. Consequently, Ofreg did not have bridging letters for any periods not covered by the SOC reports.</p>	<p>timely fashion. Ofreg should also ensure that the end-user controls they are required under the SOC 2 reports (to complement the third party's controls) to have in place are operating effectively.</p>		
<p>9. Delayed publishing of the Annual Plan for 2024</p> <p>The annual plan for 2024 has not yet been published, contrary to URCA section 41(1), which requires OfReg to prepare and publish the plan no later than one month before the end of each year (end of November of each year). The Annual plan should include a proposed objective for the forthcoming year, a report on the performance of its functions in the financial year, and its approved budget for the forthcoming year.</p>	<p>Risk/Implication</p> <p>Delays in publishing the annual report hinder the effective implementation of regulatory strategies in various sectors.</p> <p>Recommendation</p> <p>OfReg should ensure timely publishing of the Annual plan to ensure effective oversight of all regulated areas.</p>	<p>The publication of the Annual Plan 2024 has been delayed but is now in draft form it will be published shortly after the Board has agreed to it.</p>	<p>June 2024</p>