Grant Thornton

Strengthening your internal controls: Tips, tactics and best practices

In an effort to cut costs, improve service to local communities and realize operational efficiencies, Local Distribution Companies (LDCs) across Canada have been engaging in value-enhancing mergers. However, to unlock the full value of a merger, the merging companies need to be aware of some common pitfalls—and those include relying on disparate internal controls.

If merging companies don't take the time to integrate their internal controls, employees may be uncertain about which processes to follow and critical activities could fall through the cracks. Failure to standardize processes also makes it harder to measure improvements or identify gaps, preventing LDCs from using their internal controls to drive productivity.

In light of these risks, companies need to take steps to align their internal controls, test and improve them on a regular basis and overcome the common barriers they may face in implementing effective internal controls.

Bring your controls into alignment

No two companies ever use the same processes to complete key activities, which can cause real confusion following a merger. That's why it's important to bring your internal controls into alignment. There are two ways to streamline this:

- **Learn from each other.** Rather than simply adopting the internal controls of one organization or the other, review each organization's controls following a merger to identify what works and what doesn't. This can position you to craft new controls that leverage the best of both worlds.
- **Automate.** A merger often provides companies with an opportunity to update their legacy systems and put more efficient technologies into place—opening up the potential to automate internal controls. Through automation, LDCs can reduce the human errors that often creep into manual processes, improve process efficiency and cut down on the workarounds that can sometimes lead to fraud.

It's also important to develop formal documentation, both so staff understand what's expected of them and to prevent losing critical knowledge if key employees change jobs, take parental leave, head out on extended leave or retire.

Once policies are documented, they also need to be communicated to staff. Simply posting them on your intranet isn't sufficient. If you expect staff to follow potentially new post-merger processes, you'll need to provide training and education that outlines your organization's risk appetite and risk tolerance and sets out expectations around employee behaviour.

Conduct regular testing

Although it's tempting to think that your work is done once your internal controls are automated, standardized and properly documented, this isn't actually the case. In today's competitive energy sector, things shift quickly, which is why it's important for LDCs to evaluate their controls framework on a regular basis. This means revisiting your internal controls and conducting ongoing testing.

Typically, this involves implementing key performance indicators (KPIs) to measure if your internal controls are designed and operating effectively. That way, if you test your controls and identify deficiencies or gaps, you can develop action plans to remediate them.

Accountability is really important here—which is why your action plans should assign responsibilities and set timelines for remediation. This will let you uncover the root cause if a plan isn't adopted.

Perhaps it wasn't practical or affordable. Or maybe a third party failed to deliver on their commitments. By pinpointing the reason behind the delay, you'll be better placed to get back on track—and avoid similar missteps in the future.

Another way to strengthen internal controls is by performing self-assessments. Electricity regulatory boards often highlight areas of focus, where LDC internal controls may be weak. This gives you an opportunity to get ahead of the game by self-assessing your performance in those areas, rather than waiting for the regulatory board to come calling. Even if your internal controls aren't up to the expected standard, you're more likely to garner regulatory support if you can demonstrate the steps you're taking to proactively meet their requirements.

To ensure your internal controls are designed and operating effectively, it can also be helpful to ask your Internal Audit function or a third party provider to perform a risk assessment. Top priority risks should shift in line with changing market dynamics. For instance, while cybersecurity may not have represented an immediate risk ten years ago, it may today.

Overcome common barriers

Despite their best efforts, LDCs will likely struggle to implement effective internal controls unless they can overcome some common organizational barriers.

The biggest one is often lack of buy-in from senior management and the board. Tone from the top heavily influences how companies approach risk management. If you want your employees to adhere to the internal controls you set, you need executive support.

A second challenge is human capital. To build a strong internal controls environment, LDCs need the right people in the right roles with the right skills—whether you have to hire them externally or train existing staff. These skills should include not only the ability to implement and monitor internal controls, but also the ability to train and motivate employees to follow them.

A third barrier can be the composition of the board. If the board isn't sufficiently diverse, there's a greater danger of failing to identify emerging risks. To prevent controls gaps, your board will ideally be composed of members with different genders, ethnicities, backgrounds, industry experience and ages. The aim is to create an environment that encourages diversity of thought and celebrates open-minded discussions. If your board is stagnating, you may want to perform self-assessments, limit board member terms and be honest about the need for change.

Fourth, internal control missteps often happen because of a lack of transparency. Either communication between the LDC, regulators, municipalities, board members and senior management is weak or LDCs fail to get ahead of bad news stories. Either way, without open and honest disclosure, the control environment will suffer.

Positioning for success

Although it can take time and effort to put the proper controls into place following a merger, getting it right can give LDCs the confidence to know that their risks are being effectively managed. This can free you up to focus on the core strategies that will drive your growth into the future.

To learn more about how Grant Thornton can help your LDC strengthen its internal controls, contact us.

Jen Pavlov
Senior Manager, Business Risk Services
T +1 416 369 6421
E Jen.Pavlov@ca.gt.com

David Florio
Partner, Business Risk Services
T +1 416 369 6415
E David.Florio@ca.gt.com

Grant Thornton

About Grant Thornton LLP in Canada
Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. We help dynamic organizations unlock their potential for growth by providing meaningful, actionable advice through a broad range of services. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member and correspondent firms operate in over 100 countries worldwide.