

Nalcor Energy

Independent Auditor's Report



November 2022

OFFICE OF THE AUDITOR GENERAL
NEWFOUNDLAND AND LABRADOR



Objective

To determine whether Nalcor Energy's employee compensation was comparable to government and industry.



Audit Period: January 2013 through December 2018.



Why this Audit is Important

Employee compensation is the most significant cost for the public service. As a public sector corporation, it is critical that Nalcor pursue a prudent compensation approach that aims to achieve the best possible use of public money.



Conclusions

Overall, Nalcor's management and executive employees' total compensation was, and continues to be, higher than the total compensation of comparable provincial government positions.

Nalcor's executive and management positions had the same accountability, problem-solving, and know-how ratings as equivalent government positions, yet they were paid more money. Nalcor continually increased or broadened salary scales, even after bonuses and incentive programs were removed. Nalcor's executive and management employees receive retiring allowances, higher insurance benefits, and better leave entitlements than government employees. We could not determine any business reason for this variance. It appears salary and benefit levels will not be comparable to government unless changes are made.

Nalcor's compensation for the majority of the positions we reviewed was higher than comparable positions assessed against industry benchmarks. While Nalcor executive and management staff may not have received general economic increases since 2016, the increases to salary levels, pay scales, bonuses and incentives, as well as employee benefits, over the past ten years has resulted in compensation costs higher than government.

The inherent conflict of being a public sector organization that has to compete with the private sector for human resources is a complicating and challenging factor for Nalcor, but also for government. When a public sector entity's salary and benefits practices are more lucrative than others, it creates disparity in the public service, adds to recruitment and retention challenges, and ultimately reduces the public's trust that public money is being managed appropriately.



Recommendation for Nalcor

Nalcor should re-evaluate its compensation policies and practices to ensure the best possible use of public money, including consideration of alignment with government classification, pay scales, and benefits policies.



After reading this report, you may want to ask the following questions of government:

1. How does government ensure consistency in executive and management compensation across the public service?
2. How will the findings in this audit influence how government manages its employee benefit costs and employee entitlements?



What We Found

We found that Nalcor (and its subsidiaries) paid higher base salaries than the provincial government for all 35 management and executive positions we examined. Since accountability, problem-solving, and know-how ratings were the same, we could not determine any business reason why there were such differences in the salary pay scales.

Between 2017 and 2018, Nalcor’s Board of Directors:

- Approved the implementation of executive salary scales higher than prior employment contract base salary levels and allowed executives to exceed the top of the pay scale by 20 per cent, and
- Approved a new management salary structure with less classifications and broader pay ranges, and allowed management to exceed the top of the scale by 10 per cent. For context, these changes happened when provincial government employees were under a pay freeze.

From 2013 to 2018, approximately 15 executive employees were given an average of \$46,000 each in incentive payments annually; approximately 70 senior management employees were given an average of \$16,000 each in incentive payments in lieu of bonuses; and approximately \$1.5 million in bonuses was paid to management employees who were at the top of their pay scale.

We also found significant differences with the benefits package offered:

Nalcor	Government
100% employer-paid group health and life insurance plan premiums	50% employer-paid group health and life insurance plan premiums
75% employer paid dental plan premiums	0% employer paid dental plan premiums
\$12,740 annual car allowance to executive employees or exclusive use of a fleet vehicle with a gas card	Mileage reimbursement for work-related travel
Retiring allowance of up to 26 weeks’ salary	No retiring allowance; 20 weeks’ severance policy ended in 2018
Up to 108 employer-paid leave days annually	25 to 35 employer-paid leave days annually, depending on years of service

We found that Nalcor’s base salaries were above many of the benchmarks found in the industry. Specifically, we found that executive employee total compensation was at the high end of the range of Canadian industry markets. Management employee total compensation was also above Nalcor’s benchmark of the Atlantic Canada electric utilities market. Canadian compensation planning surveys reported average increases ranging from 0.3 per cent to 4.4 per cent annually, while Nalcor employees received increases ranging from four to eight per cent annually.

While we were unable to compare many aspects of Nalcor management or executive benefits against industry benchmarks due to a lack of comparable data, we did note that the value of offering a defined benefit pension plan resulted in above-industry benefits for Nalcor employees.

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Background

Nalcor Energy (Nalcor) was incorporated in 2007 under the Energy Corporation Act as a Crown corporation. Its business lines included the development, generation, and sale of electricity; the exploration, development, production, and sale of oil and gas; energy marketing; and industrial fabrication site management. On June 23, 2021, the Provincial Government announced that the operations of Nalcor would be moving under Newfoundland and Labrador Hydro (NL Hydro).

Our audit period covers January 2013 to December 2018. Our audit included four lines of inquiry, with three of those previously reported on October 6, 2022. The fourth line of inquiry, compensation, has two criteria and is the subject of this report. A summary of key findings and recommendations from the complete Nalcor Energy audit can be found in Appendix II.

This audit report focuses on the total compensation paid to an employee, which is the total of any salary, bonuses, incentives, and benefits provided to that employee.

The five compensation components outlined in this report are:

Base Salary: Compensation paid for a position, based on a pre-determined pay scale. Pay scales coincide with the points rating given to a position using a job evaluation methodology, also known as position classification. Accountability, problem-solving, and know-how are the criteria used in this methodology. There are three classes of management pay scales at Nalcor - Churchill Falls, petro-tech, and Nalcor/NL Hydro. For this audit, we use the top of the pay scale for comparisons to the provincial government and external reference markets. The provincial government has not adjusted their pay scales other than for general economic increases. Any general economic increases, also known as cost of living increases, will increase all pay scales. Per government's order in council (OC2016-211), Nalcor management and executive staff have not received any general economic increases since 2016.

Salary Increases: Pay increases along a position's base salary scale, until an employee reaches the top of the pay scale. For Nalcor, increases result from annual performance reviews and are calculated at annually determined percentages approved by the Board of Directors. Provincial government employees progress on the pay scale occurs annually at pre-determined steps, and government does have a market adjustment policy that applies to management employees.

Bonuses: Annual lump sum payments in excess of the base salary. For Nalcor, if a management employee's performance review results in "exceeds expectations" or "exceptional results" ratings and they have reached the top of the pay scale, they will receive bonuses, also known as merit cash payments. These payments are calculated as percentages of the base salary, are non-pensionable and are approved by the Board of Directors. Nalcor employees paid bonuses are not eligible for short-term incentives. The provincial government does not provide any form of bonus compensation.

Incentives: Annual lump sum cash payments, also known as incentive compensation. For Nalcor, short-term incentives are paid to executive and selected senior management; long-term incentives are possible for executive but were not provided during the scope of our audit. Payment is tied to corporate and divisional performance as defined in the employee's performance contracts, is non-pensionable and calculated as a percentage of base salary. Employees paid short-term incentives are not eligible for bonuses. The provincial government does not provide any form of incentive compensation.

Background

Benefits: Compensation paid beyond salary, bonuses, and incentives. For Nalcor and the provincial government, employment-related benefits include group insurance premium cost-sharing, matched defined benefit pension contributions, and leave entitlements.

Nalcor's compensation expense for the calendar year 2018 was \$180.5 million, which was comprised of \$90.9 million for 950 management employees, \$84.8 million for bargaining unit employees, and \$4.8 million for 17 executive employees.

Compensation paid to Nalcor executive employees was comprised of base salaries, salary increases, incentive payments and benefits. Compensation paid to Nalcor management employees consisted of base salaries, salary increases, bonuses and benefits. Compensation for selected senior management employees may include incentive payments in lieu of bonuses. For government comparison, compensation paid to management and executive consisted of base salaries, salary increases and benefits.

For this audit report, other types of employees, such as bargaining unit and casual employees, or embedded contractors, were not considered. Non-bargaining/non-management employees are included in management comparisons. All Nalcor subsidiaries are included in this audit report.

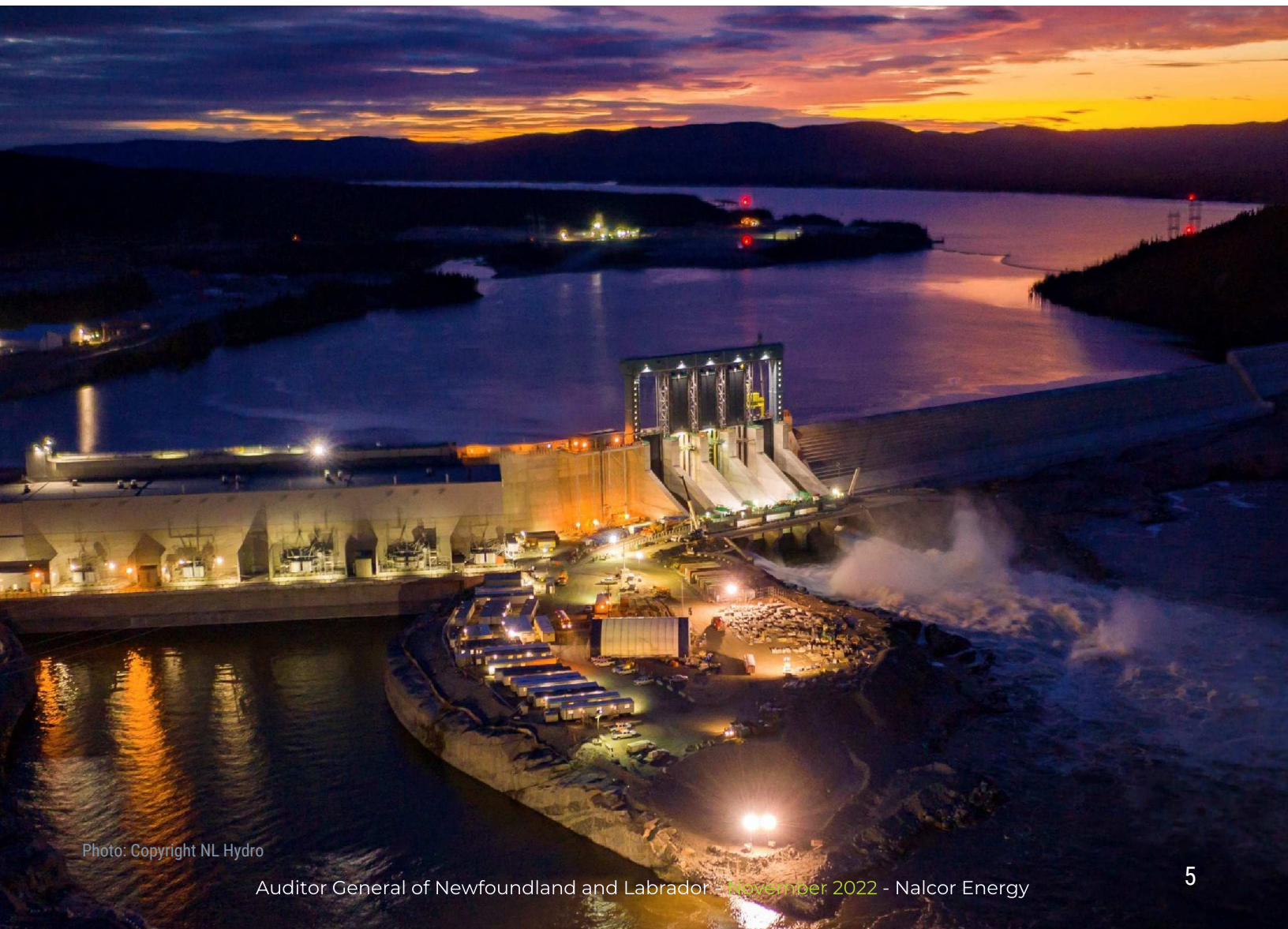


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Findings

Comparison to Government Compensation

Criteria 1

Nalcor's employee compensation is comparable to provincial government compensation.



What We Expected

We expected Nalcor to be highly aware of its roles and responsibilities as a public sector corporation. It is reasonable to expect that this responsibility would result in the prudent pursuit of the lowest-cost alternatives, particularly where compensation expenses were concerned. Government's Order in Council (OC2010-323) provided Nalcor with an exemption to the application of government's Treasury Board compensation policies. However, we would have expected Nalcor to avail of these exemptions with fiscal discretion.

Government policy requires its entities to pay their employees in accordance with position classification as approved by the Treasury Board and in accordance with government compensation policies. We expected positions that were classified the same to be paid the same, regardless of where the public sector employee worked. It is reasonable to expect that government direction to Nalcor to eliminate or freeze compensation components did not result in alternative forms of compensation being implemented.



What We Learned

We found that Nalcor paid significantly higher total compensation as compared to the provincial government for all of the 35 management and executive positions we examined. All 35 positions had higher total salary costs than comparable government positions.

We performed our examination with the assistance of a job evaluation consultant that compared 35 Nalcor executive and management positions against positions in the provincial government that had comparable assessments (also known as points ratings) for accountability, problem-solving, and know-how criteria under the methodology. Our consultant verified that Nalcor and government use the same job evaluation methodology. The consultant also verified that both use this methodology appropriately and consistently, in that they use its criteria when assessing position points to assign a rating classification. The methodology requires that this classification is then assigned to the organization-specific pay scales for the positions assessed. We used the base salaries that were in effect on April 1, 2018, at Nalcor and at government.

We have separated our findings for executive and management employees, due to the differences in compensation components that are applicable.

Executive Employees

For the three executive positions we examined, we found that Nalcor paid significantly higher salaries than government. Since the assessment of accountability, problem-solving, and know-how were the same, the comparable deputy minister and assistant deputy minister positions are equivalent from a compensation point of view. Yet, the salary pay scales for the equivalent positions varied significantly.

Similar to our other lines of inquiry released in October 2022, we have classified the three executive audit samples as corporate or technical. We could not determine any business reason why there were such significant differences in the pay scales for the corporate and technical executive positions in our sample.

**Table 1 - Nalcor Positions as Compared to Government Positions
Annual Executive Salary Compensation
As of April 2018**

Executive Position	Nalcor Base Salary (top of scale)	Nalcor Bonuses	Nalcor Incentives	Nalcor Total Salary	Government Base Salary (top of scale)	Minimal Annual Salary Difference
Executive Vice-President, Power Supply (Technical)	\$355,000	N/A	\$85,200	\$440,200	\$168,873	\$271,327
Chief Human Resources Officer and Vice-President Safety, Health and Sustainability (Corporate)	\$258,000	N/A	\$61,920	\$319,920	\$126,855	\$193,065
Vice-President, Transmission, Distribution and NL System Operator (Technical)	\$215,000	N/A	\$51,600	\$266,600	\$127,109	\$139,581

Source: Prepared by the Office of the Auditor General based upon information provided by Nalcor and the Treasury Board Secretariat (unaudited)

Note 1: Government base salaries are Deputy Minister and Assistant Deputy Minister equivalent positions.

Note 2: All compensation components reflect maximum rates for the positions based on entity policy and practice; we did not reconcile this information to public information disclosures.

The Nalcor corporate position in our sample - Chief Human Resources Officer and Vice-President Safety, Health and Sustainability - with a total annual compensation of \$319,920, was more than two and a half times that of a comparable executive position in the provincial government.

One of the two technical executive positions we reviewed - Executive Vice-President, Power Supply - had a total annual compensation of \$440,200, which was more than double that of a comparable provincial government executive position. The Vice-President Transmission, Distribution and Newfoundland and Labrador System Operator position's total salary of \$266,600 was also double the \$127,019 salary for a comparable government position.

Nalcor executive employees were compensated at increasingly higher base rates during our audit scope period. In 2013, all Nalcor executive positions received a four per cent salary increase compared to a one-time payment of \$1,400 paid to provincial government employees. Nalcor's four per cent increase had a permanent impact on salary scales and future pension earnings as compared to the government one-time payment, which was not pensionable earnings.

In October 2016, government-directed Nalcor to discontinue the cost-of-living adjustment for all employees, per Order in Council OC2016-211. Nalcor followed this directive and, as a result, did not provide these adjustments from 2016 to 2018 (the remainder of our scope period) which is consistent with government's own actions.

Salary pay scales were modified during our audit scope period. Prior to April 2017, Nalcor executive were paid based on negotiated salary levels defined in their employment contracts.

In 2016, Nalcor engaged a consultant to perform a compensation review which was completed in October of the same year. Based on this review, Nalcor's Board of Directors approved the implementation of pay scales effective April 1, 2017, which were higher than prior employment contract base salary levels. These new salary ranges allowed the maximum base salary level to be 120 per cent of the pay scale. As a result, salary ranges for some positions increased by as much as \$30,000 (16 per cent) above the lowest contract salary of the previous year (2016-17), without any change in their accountability, problem-solving, or know-how classification ratings. For context, this change happened when provincial government employees were under a pay freeze.

In 2017, Nalcor engaged a separate consultant to review executive position compensation. These positions had pay scales that had already been increased as a result of the 2016 review and board decision. In November 2017, Nalcor's board approved further revisions to the executive vice-president pay scales, effective April 1, 2018. The executive vice-president positions received an additional 14.5 per cent increase, without any change in their accountability, problem-solving, or know-how classification ratings.

Nalcor executive employees received short-term incentive payments in accordance with their performance contract clauses. This form of performance pay was tied directly to specific, measurable objectives related to both corporate and divisional performance. In 2017, Nalcor's board approved a change in the performance indicators weights making employees eligible for a higher payout if they met the performance criteria. This compensation allowed for performance contract targets that were as high as 20 per cent of base salaries prior to 2017 and increased to as high as 24 per cent in 2017 onward. There were approximately 15 executive employees given an average of \$46,000 each in incentive payments annually from 2013 to 2018.

In 2010, the provincial government launched a pilot program for performance pay applicable to deputy ministers and equivalents at applicable Crown agencies valued at up to ten per cent of base salaries. This pilot was ended in 2013/14. Due to the exemption granted via government's order in council (OC2010-323), Nalcor was not compelled to follow provincial government policy and continued to provide performance contract payments during our audit scope period.



Management Employees

We found that Nalcor paid significantly higher salaries than government for all 32 management positions that we examined. Since the assessment of accountability, problem-solving, and know-how were the same, the comparable management positions are equivalent from a compensation point of view. Yet, the pay scales for the positions varied significantly.

Similar to our other lines of inquiry released in October 2022, we classified the 32 management audit samples as corporate or technical. There were 13 corporate management positions, which included accounting, human resources, health and safety, and other administrative management functions. There were 19 technical positions, which included electrical and engineering management positions. Two out of three pay scales, Churchill Falls and petro-tech, have higher base salaries than Nalcor/NL Hydro.

We could not determine any business reason why there were such differences in the pay scales for the corporate and technical management positions in our sample.

Nalcor's corporate management position salaries that we reviewed were all higher than comparable government positions, with differences ranging between \$9,491 (16 per cent) for the Environmental Coordinator position, up to \$90,736 (75 per cent) for the General Manager, Finance position.

**Table 2 - Nalcor Positions as Compared to Government Positions
Annual Management Salary Compensation - As of April 2018**

Corporate Management Position	Nalcor Base Salary (top of scale)	Nalcor Bonuses	Nalcor Incentives	Nalcor Total Salary	Government Base Salary (top of scale)	Minimal Annual Salary Difference
General Manager, Finance	\$180,000	N/A	\$32,400	\$212,400	\$121,664	\$90,736
Manager, Environment Operations	\$151,000	N/A	\$18,120	\$169,120	\$103,868	\$65,252
Manager, Safety & Health	\$151,000	N/A	\$18,120	\$169,120	\$105,928	\$63,192
Manager, Safety, Health, & Environment	\$124,800	N/A	\$14,976	\$139,776	\$94,667	\$45,109
Assistant Corporate Secretary & Legal Counsel	\$124,800	N/A	\$14,976	\$139,776	\$105,928	\$33,848
Manager, Engineering Support Services	\$116,300	\$5,815	N/A	\$122,115	\$90,094	\$32,021
Manager, Key Accounts	\$107,900	\$5,395	N/A	\$113,295	\$81,635	\$31,660
Customer Service Process & Project Lead	\$96,850	\$4,843	N/A	\$101,693	\$77,748	\$23,945
Corporate Safety Specialist	\$107,900	\$5,395	N/A	\$113,293	\$90,094	\$23,201
Human Resources Specialist, Compensation	\$107,900	\$5,395	N/A	\$113,295	\$90,094	\$23,201
Human Resources/Labour Relations Advisor	\$92,200	\$4,610	N/A	\$96,810	\$74,318	\$22,492
Manager, Accounting	\$116,300	\$5,815	N/A	\$122,115	\$99,925	\$22,190
Environmental Coordinator	\$66,100	\$3,365	N/A	\$69,405	\$59,914	\$9,491

Source: Prepared by the Office of the Auditor General based upon information provided by Nalcor and the Treasury Board Secretariat (unaudited)

Note 1: Government base salaries are manager or director equivalent positions.

Note 2: All compensation components reflect maximum rates for the positions based on entity policy and practice; we did not reconcile this information to public information disclosures.

**Table 3 - Nalcor Positions as Compared to Government Positions
Annual Management Salary Compensation - As of April 2018**

Technical Management Position	Nalcor Base Salary (top of scale)	Nalcor Bonuses	Nalcor Incentives	Nalcor Total Salary	Government Base Salary (top of scale)	Minimal Annual Salary Difference
Manager, Production	\$195,300	N/A	\$35,154	\$230,454	\$113,672	\$116,782
Manager, Tech & Design Integrity	\$180,000	N/A	\$32,400	\$212,400	\$113,672	\$98,728
General Manager, Energy Marketing	\$180,000	N/A	\$32,400	\$212,400	\$113,672	\$98,728
General Manager, HVDC/HVAC Transmission	\$180,000	N/A	\$32,400	\$212,400	\$113,672	\$98,728
Chief Geophysicist	\$155,800	N/A	\$18,696	\$174,496	\$99,925	\$74,571
Development Geophysicist	\$142,650	\$7,133	N/A	\$149,783	\$85,522	\$64,261
Manager, Engineering & Office Management	\$151,000	N/A	18,120	\$169,120	\$105,928	\$63,192
Manager, TRO Central	\$151,000	N/A	18,120	\$169,120	\$108,399	\$60,721
Manager, Hydro Generation	\$151,000	N/A	18,120	\$169,120	\$108,399	\$60,721
Supervisor, Protection & Control	\$111,100	\$5,555	N/A	\$116,655	\$74,318	\$42,337
Supervisor, Electrical/Mechanical	\$92,200	\$4,610	N/A	\$96,810	\$65,174	\$31,636
Electrical Designer	\$92,200	\$4,610	N/A	\$96,810	\$65,174	\$31,636
Engineer, Electrical Design Level IV	\$124,800	\$6,240	N/A	131,040	\$99,925	\$31,115
Project Leader	\$107,900	\$5,395	N/A	113,295	\$85,522	\$27,773
Shift Supervisor - Energy Control	\$96,850	\$4,843	N/A	101,693	\$74,318	\$27,375
Engineer, Civil Level III	\$116,300	\$5,815	N/A	122,115	\$99,925	\$22,190
Manager, Bull Arm Operations	\$116,300	\$5,815	N/A	122,115	\$99,925	\$22,190
Real Properties Coordinator/Geomatic Lead	\$92,200	\$4,610	N/A	96,925	\$77,748	\$19,062
Civil Construction Coordinator	\$66,100	\$3,305	N/A	\$69,405	\$59,914	\$9,491

Source: Prepared by the Office of the Auditor General based upon information provided by Nalcor and the Treasury Board Secretariat (unaudited)

Note 1: Government base salaries are manager or director equivalent positions.

Note 2: All compensation components reflect maximum rates for the positions based on entity policy and practice; we did not reconcile this information to public information disclosures.

Nalcor’s technical management position salaries that we reviewed were all higher than comparable government positions, with the differences ranging between \$9,491 (16 per cent) for the Civil Construction Coordinator position to \$116,782 (103 per cent) for the Manager, Production position.

Nalcor management employees were compensated at increasingly higher base rates during our audit scope period. In 2013, all Nalcor management employees received a four per cent salary increase compared to a one-time payment of \$1,400 for provincial government employees. Nalcor's four per cent increase had a permanent impact on salary scales and future pension earnings, as compared to the government one-time payment, which was not pensionable earnings.

In October 2016, government directed that Nalcor discontinue the cost-of-living adjustment for all employees, per Order in Council OC2016-211. Nalcor followed this directive and, as a result, did not provide these adjustments from 2016 to 2018 (the remainder of our scope period) which was consistent with government’s own actions.

From 2013 to 2018, management employees progressed annually within their base salary scales as a result of receiving increases based on their performance evaluation results, which ranged from four per cent to eight per cent as approved by Nalcor’s board. Once a management employee reached the top of their pay scale, they were eligible annually for a bonus based on their annual performance evaluation. Bonuses ranged between two and a half per cent and six per cent.

There was also a change to salary scales in April 2018 that resulted in a reduction of classification levels but broadened the scales.

From 2013 to 2018 Nalcor paid approximately \$1.5 million in bonuses related to management employees since they were at the top of their salary scale, as outlined in Table 4. Nalcor officials advised that these payments were supported by annual performance evaluations of “exceeds expectations” and “exceptional performance”.

Table 4 - Management Employee Bonuses

Years Ending December 31	Number of Employees	Average Payment per Employee	Total Payments
2013	78	\$2,503	\$195,257
2014	89	\$2,883	\$256,596
2015	100	\$2,765	\$276,470
2016	93	\$2,514	\$233,838
2017	85	\$3,014	\$256,180
2018	95	\$2,894	\$274,924
Total			\$1,493,265

Source: Prepared by the Office of the Auditor General based on data obtained from Nalcor (unaudited)

Provincial government employees receive pre-determined annual salary adjustments on the anniversary date they were hired, averaging three to four per cent annually. The salary increases within a salary range are pre-determined based on step increments and the increases end once the employee is at the top of their scale. In the provincial government, step increments do not normally go beyond the top of the scale and government does not provide salary adjustments or incentive payments as a form of compensation for performance.

As a result of a 2018 consultant's market compensation review, a new salary structure was approved by Nalcor's board that same year for its management staff. Nalcor also adopted broader pay scale ranges in 2018 to replace the bonus payments. The broader scales allowed management staff to progress beyond the top of the scale by ten per cent, without any change to the position's accountability, problem-solving, or know-how ratings. This change also meant that high performers would have higher pensionable earnings available at retirement, as the bonuses paid previously were not pensionable.

Nalcor senior management employees received short-term incentive payments, in accordance with their performance contract clauses and in lieu of bonuses. This form of performance pay was tied directly to specific, measurable objectives related to both corporate and divisional performance. This compensation allowed for performance contract targets that were as high as 15 per cent of base salaries prior to 2017 and 18 per cent in 2017 onward for one senior management group and 10 per cent prior to 2017 and 12 per cent after for a second senior management group. There were approximately 70 employees that were paid an average of \$16,000 annually.

The provincial government did not provide any form of performance pay to its management employees.



Management and Executive Employee Benefits

We found significant differences between the benefits package Nalcor offered its employees and the benefits package offered by government. We could not find any business reason why Nalcor's employee benefits, and the resulting employer costs, would be more than the rest of the public service. Specifically, we noted:

Group Health/Life and Dental Insurance

Nalcor paid 100 per cent of its employees' group health and life insurance premiums and 75 per cent of dental plan premiums. Nalcor paid 50 per cent of retirees' group health and life insurance premiums and 75 per cent of their dental plan premiums. These benefits are significantly higher than government's 50 per cent payment for group health and life insurance premiums and 50 per cent for group health and life insurance for retirees. Government does not pay any dental plan premiums for employees or retirees.

These higher premium percentages resulted in additional compensation costs of more than \$2 million annually for Nalcor. While we did not fully audit the coverage of the group health, life, and dental insurances, we do note that it appears that Nalcor offered more benefits than the provincial government's plan. For example, Nalcor's Basic Life and Accidental Death and Dismemberment coverage was at three times an employee's salary as compared to government, which includes a benefit of two times an employee's salary.

Car Allowances

Nalcor provided car allowances to all of its executive staff: the Chief Executive Officer, executive vice presidents, and vice presidents. Each executive employee was paid a \$12,740 taxable car allowance annually (\$490 biweekly) or assigned a fleet vehicle for exclusive use with a fleet gas card. In comparison, government generally does not provide car allowances to executive staff, instead offering mileage reimbursement for work-related travel.

Retiring Allowances

Nalcor paid a retiring allowance of up to a maximum of 26 weeks' salary based on up to 26 years of completed service (regardless of whether the years were continuous). In comparison, government ended its severance policy in May 2018, at which time it paid employees to a maximum of 20 weeks' salary if employees had up to 20 continuous service years.

Northern/Labrador Allowances

Nalcor pays an annual Northern/Labrador allowance that is as much as \$398 more than government for single employees and as much as \$607 more than government for employees with dependents.

Leave Entitlements

Annually, Nalcor executive and management employees received between 15 and 28 vacation leave days depending on years of service, as well as five family and personal leave days. Nalcor management employees also had access to an employer-paid short-term disability leave program, which provided up to 75 paid sick days per occurrence. Combined, Nalcor's leave entitlements could have totalled up to an annual 108 paid leave days.

By comparison, provincial government employees receive between 25 and 35 paid leave days annually depending on years of service. Government employees do not have an employer-paid short-term disability leave program, do not earn sick leave entitlements while in executive or management positions, and do not have separate family or personal leave days.

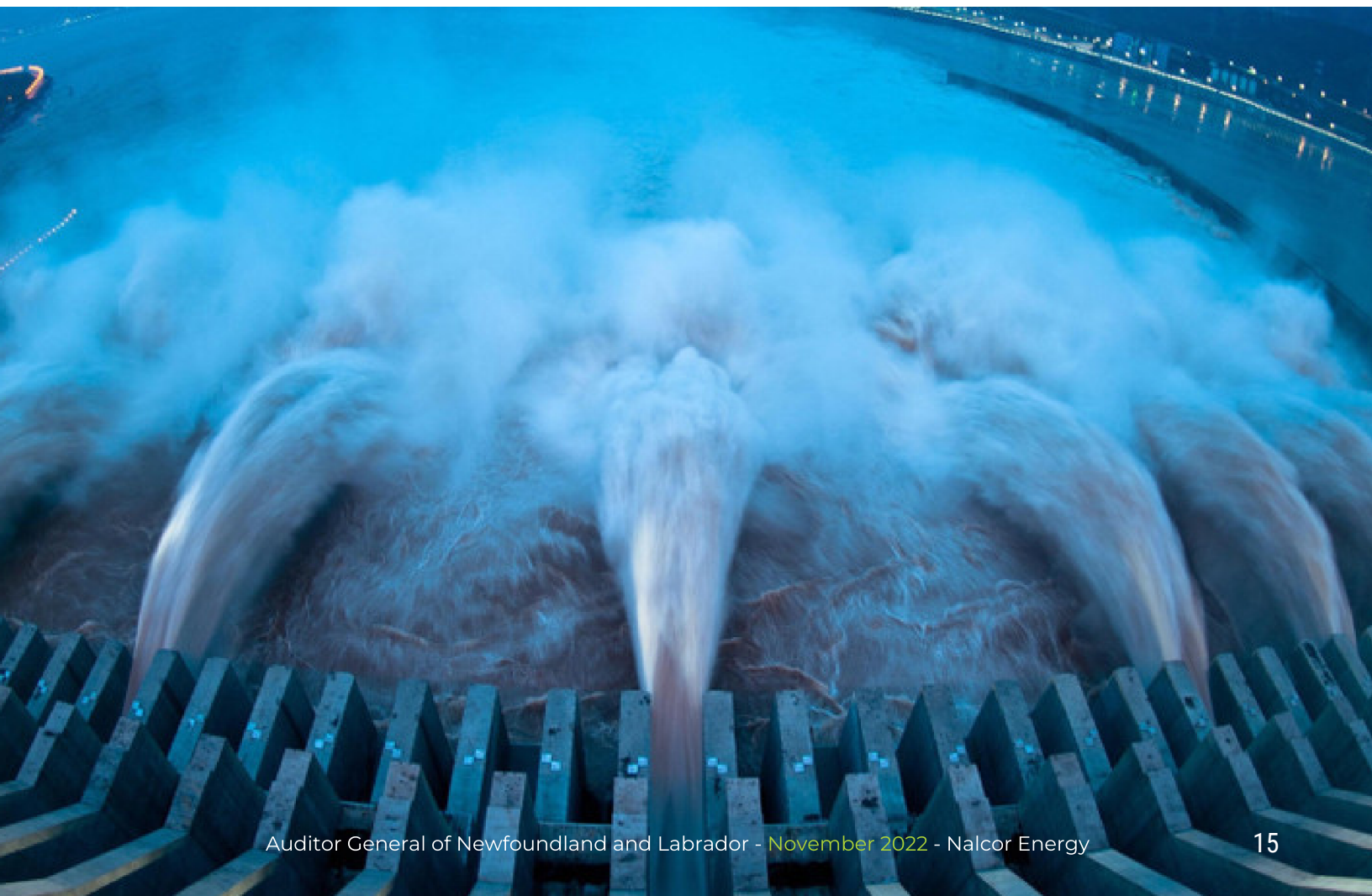
Nalcor employees using maternity leave were paid an extra two weeks' salary during their employment insurance waiting period, with a top-up of 30 per cent of their salary for 15 weeks of their maternity leave. Government employees do not receive an extra two weeks' salary and do not receive any top-up during their maternity leave. As of January 2017, Nalcor reduced the extra salary during the employee insurance waiting period from two weeks to one week.

During any period of unpaid leave, Nalcor employees accumulated vacation entitlement and accrued retiring allowance. Government employees accrue vacation entitlement for a maximum period of 20 days of unpaid leave in a year.

Why It Matters

Compensation costs were Nalcor's largest operating expense comprising, 63 per cent of its 2018 annual operating costs, and were a material factor in total capital project costs. As a public sector corporation, Nalcor had a responsibility of fiscal stewardship on behalf of taxpayers and ratepayers.

By using a consistent and appropriate compensation methodology, the public service can ensure that the accountability, problem-solving, and know-how of executive and management positions is used to correctly determine the level and value of compensation provided to an employee. When a public sector entity's salary and benefits practices are more lucrative than others, it creates disparity in the public service, adds to recruitment and retention challenges, and ultimately, reduces the public's trust that public money is being managed appropriately.



Findings

Comparison to Industry Compensation

Criteria 2

Nalcor's employee compensation is comparable to industry compensation in similar Canadian regions.



What We Expected

We expected Nalcor to be highly aware of its roles and responsibilities as a public sector corporation. As such, we expected that comparisons to industry, with respect to compensation practices, would only be relevant in instances where documented recruitment and retention issues existed, such as highly skilled technical positions. When such issues existed, it is reasonable to expect that Nalcor would consider market adjustment policies similar to those that exist in government. We expected Nalcor to conduct industry reviews every three to five years if deemed necessary from a pressing operational need, and only for the lines of business where that need existed. We also expected Nalcor to consider the value of public sector benefits, such as a defined benefit pension plan, when considering adjustments to compensation as a result of industry comparisons.



What We Learned

We found that Nalcor's base salaries were above many of the benchmarks found in the industry. Specifically, we found that executive employee salary compensation (base salaries, salary increases, and incentives) was at the high end of the range of Canadian industry markets. Management employee salary compensation (base salaries, salary increases, and bonuses and/or incentives) was also above Nalcor's benchmark of the Atlantic Canada electric utilities market.

While we were unable to compare many aspects of Nalcor management or executive benefits against industry benchmarks due to a lack of comparable data, we did note that the value of offering a defined benefit pension plan resulted in above-industry benefits for Nalcor employees.

Due to the differences in compensation components applicable, we have separated our findings for executive and management employees.

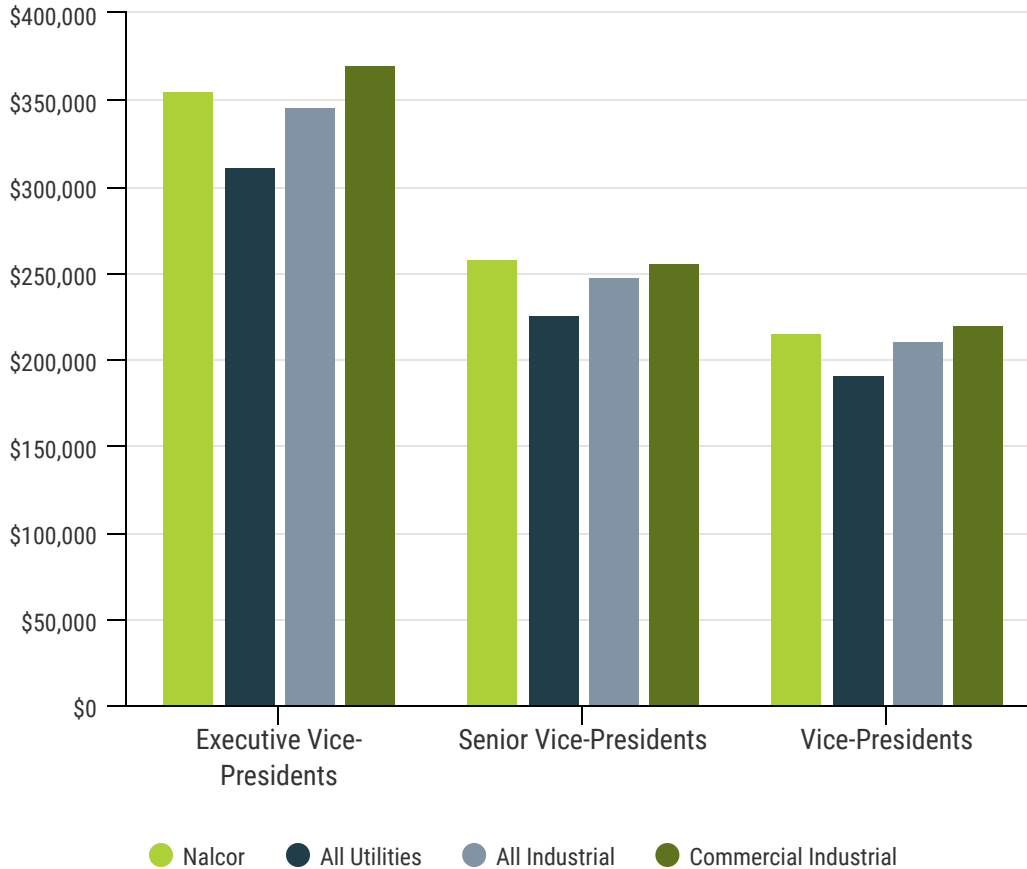
Executive Employees

Nalcor's policy regarding executive compensation required that salaries and short-term incentives are benchmarked against the Canadian General Industry, with an expectation that Nalcor would be positioned at the 50th percentile as compared to the external market. According to a Nalcor consultant, the Canadian General Industry includes private companies and non-utility companies, as well as a secondary group of selected Canadian utility companies.

We compared Nalcor's executive salary structure as of April 1, 2018, to salary rates for three different industry markets at the time. Nalcor's compensation structure and the industry market information was based on two compensation reviews that were completed by Nalcor consultants dated October 2016 and May 2017.

Graph 1 - Nalcor Executive Base Salaries as Compared to Industry Benchmarks

As of April 2018



Source: Prepared by the Office of the Auditor General based on Nalcor consultant report dated May 2017 (unaudited).

As graph 1 indicates, Nalcor’s executive base salaries were above both the utilities and industrial market benchmarks for their executive vice-presidents and both levels of vice-presidents. The senior vice-president positions were actually slightly higher than the commercial industrial market benchmark for base salary.

As previously noted, Nalcor’s short-term incentive plan for its executive employees was tied directly to individual performance contracts and allowed for performance contract targets that were as high as 20 per cent prior to 2017, and as high as 24 per cent from 2017 onward. Compensation trends provided in a consultant study showed that in 2018 Nalcor’s short-term incentives for executive vice presidents and vice presidents matched industry.

Nalcor executive employees benefit from being a part of government’s public service pension plan. A report completed by a Nalcor consultant in October 2014 noted that the public service pension plan was above the market median as compared to industry. A January 2020 research bulletin of the Fraser Institute concluded that in Newfoundland and Labrador, 93.8 per cent of public sector workers were covered by a registered pension plan compared to just 28.3 per cent of private-sector workers. This conclusion supports the notion that Nalcor executive employees benefited from a pension plan that is not typical within industry markets.

Management Employees

Nalcor’s policy regarding management compensation requires that salaries and short-term incentives are benchmarked against the Atlantic Canada electric utilities market, with an expectation that Nalcor will be positioned at the 50th percentile as compared to that external market.

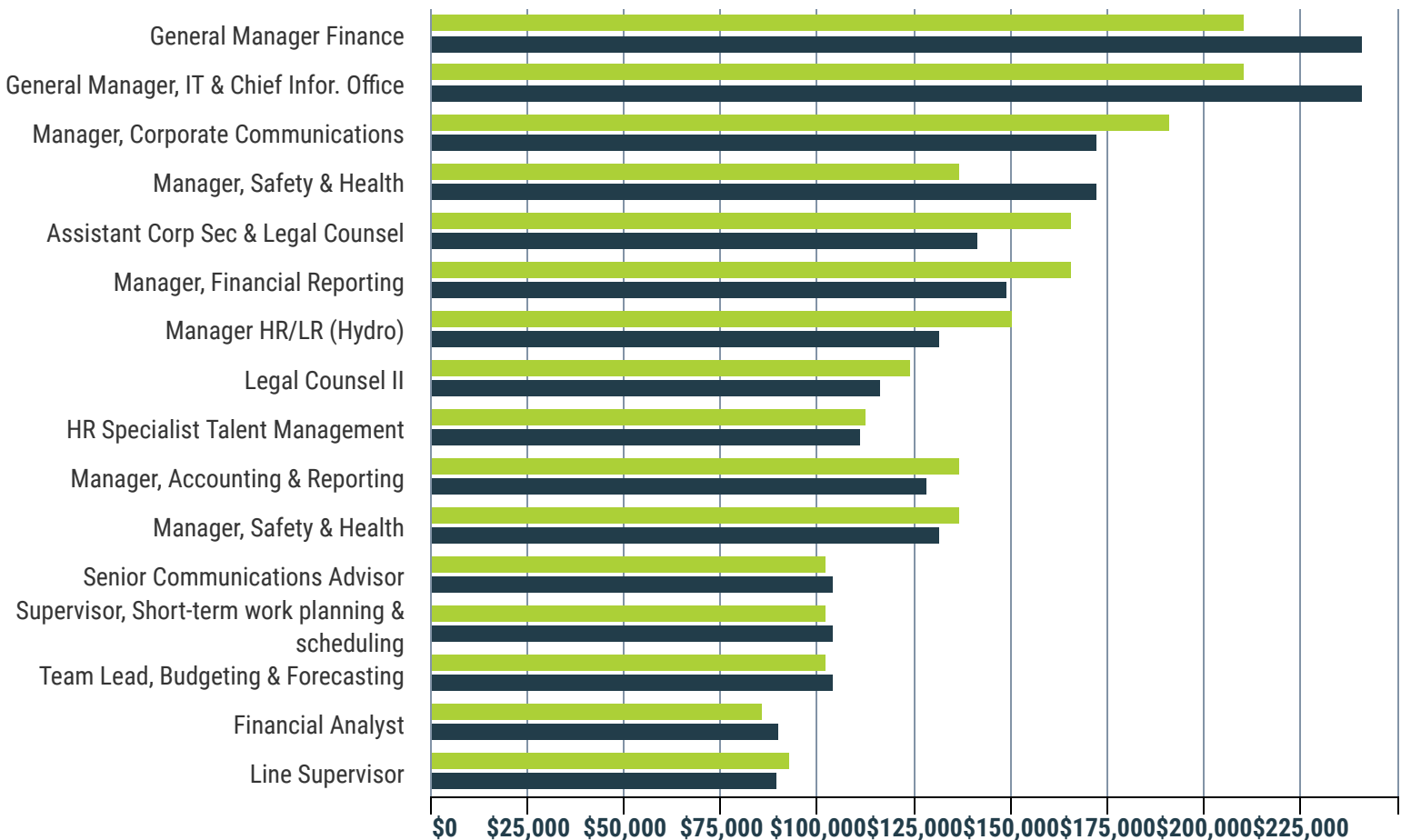
In 2018, Nalcor had an external consultant complete a compensation market review (which included 30 benchmark positions) to determine how Nalcor’s management employee compensation compared to industry. The benchmarking was completed on total salary compensation and included a comparison of base salary and short-term incentives.

The compensation market review found that Nalcor’s total compensation (based on salaries and incentives) was above the median of the Atlantic Canada utilities market for more than two-thirds (21 of 30) of the benchmark management positions.

The 30 Nalcor management positions reviewed by the consultant included 16 corporate and 14 technical positions.

The compensation market review for management corporate positions showed that Nalcor’s total compensation for more than half (10 of 16) of the corporate positions was above the corresponding Atlantic Canada utilities market salary, with an average overage in these ten positions of \$12,000 (nine per cent).

Graph 2 - Nalcor Corporate Management Positions Compared to Benchmark
As of April 2017



Source: Prepared by the Office of the Auditor General based on Nalcor consultant report dated February 2018 (unaudited).

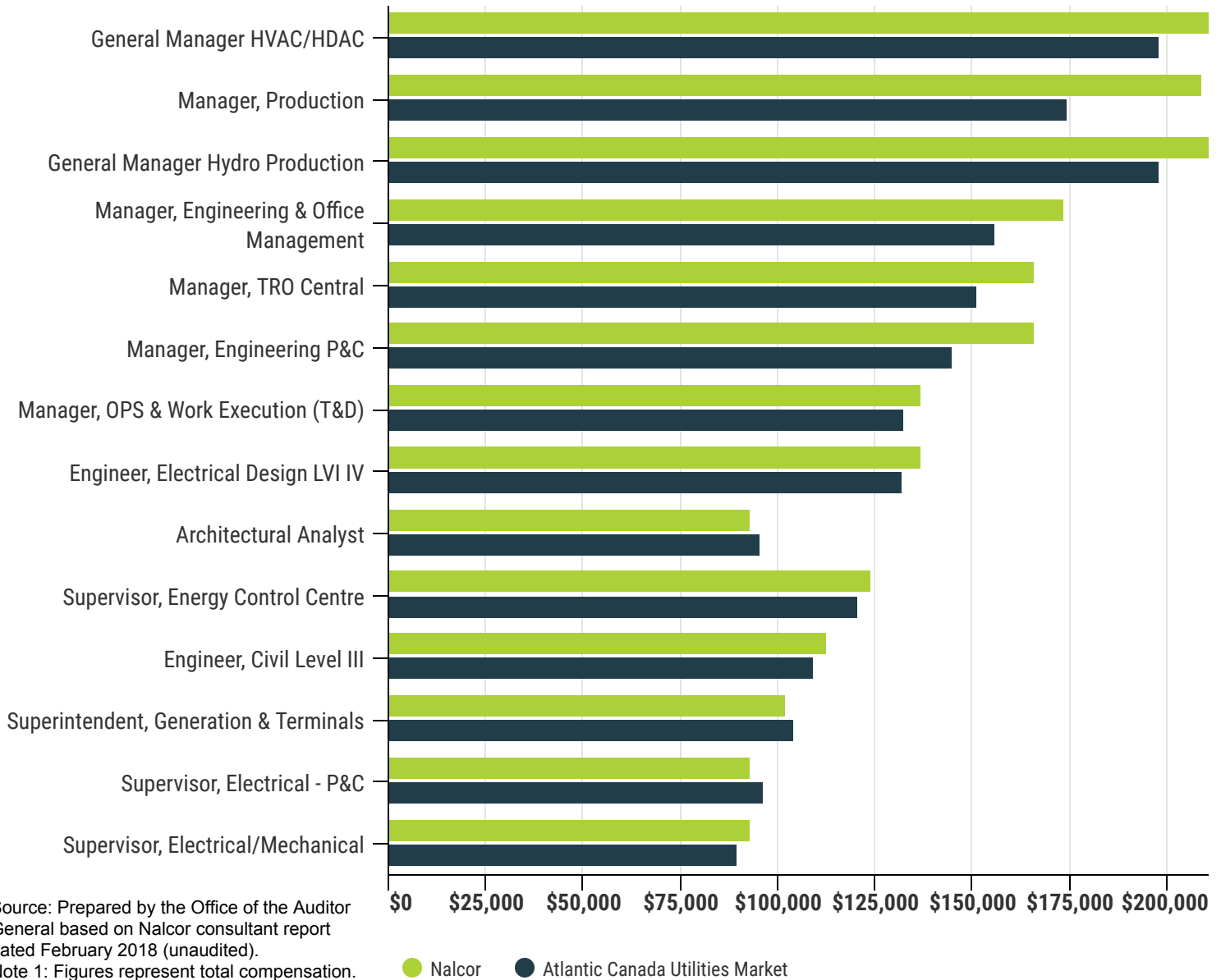
Note 1: Figures represent total compensation.

● Nalcor ● Atlantic Canada Utilities Market

The compensation market review for management technical positions showed that Nalcor’s total compensation for 11 of the 14 technical positions were above the corresponding Atlantic Canada utilities market salary, with an average overage in these 11 positions of \$12,000 (eight per cent).

Graph 3 - Nalcor Technical Management Positions Compared to Benchmark

As of April 2017



The compensation market review found that Nalcor’s base salary for almost all (27 of the 30) of the benchmark positions were above the market median of the Atlantic Canada utilities market. The overages in the 27 base salaries were \$16,000 on average and ranged between \$2,300 (3 per cent) and \$35,300 (24 per cent).

From 2013 to 2018, management employees progressed within their base salary scales annually as a result of receiving increases ranging from four to eight per cent, depending on the result of performance evaluations. For those Nalcor employees who had reached the top of their pay scale, Nalcor paid bonuses ranging between two and a half per cent and six per cent of base salary, based on above-average results in annual performance evaluations. In comparison, we found that Canadian compensation planning surveys reported average increases ranging from just 0.3 per cent to 4.4 per cent.

Nalcor provided a short-term incentive plan to senior management which provided an opportunity to earn additional compensation of between 10 and 18 per cent of their base salary. Nalcor's policy for these short-term incentives required them to be benchmarked against the Atlantic Canada electric utilities market, consistent with its base salary benchmarking policy. Thirteen of the 30 positions benchmarked by Nalcor's consultant in the 2018 compensation market review were eligible for and received short-term incentives as part of their overall compensation. The compensation benchmarking results showed that the 13 management positions received short-term incentive amounts that were, on average, approximately \$6,200 below that provided by industry. The results of this benchmarking was consistent across the corporate and technical positions.

As stated earlier regarding executive employees, Nalcor employees are also a part of government's public service pension plan. A report completed by a Nalcor consultant in October 2014 noted that the public service pension plan was above market median as compared to industry. A January 2020 research bulletin of the Fraser Institute concluded that in Newfoundland and Labrador 93.8 per cent of public sector workers were covered by a registered pension plan compared to just 28.3 per cent of private-sector workers. This conclusion supports the notion that Nalcor employees benefit from a defined pension plan that is not typical within industry markets.



Why It Matters

Compensation costs were Nalcor's largest operating expense comprising, 63 per cent of its annual 2018 operating costs and are a material factor in total capital project costs. As a public sector corporation, Nalcor had a responsibility of fiscal stewardship on behalf of taxpayers and ratepayers.

While it is fair to acknowledge that Nalcor was competing against other private sector companies for employees, Nalcor was a Crown corporation and was bound by the need for fiscal prudence, transparency, and equity across the broader public service. When a public sector entity's salary and benefits practices are more lucrative than others, it creates disparity in the public service, adds to recruitment and retention challenges, and ultimately, reduces the public's trust that public money is being managed appropriately.

Subsequent Events

Preliminary findings have been discussed with Nalcor numerous times since the end of the audit scope period in December 2018.

On April 1, 2019, bonus payments for management employees were discontinued; Nalcor did broaden their salary scales to partially offset the change.

For employees hired on or after April 1, 2020, they will pay 60 per cent of their health, life and dental insurance premiums and Nalcor will pay 40 per cent for post-employment benefits on their retirement. This cost-sharing matches government for health and life insurance premiums only since government does not pay any dental plan premiums. All Nalcor employees hired to date receive 100 per cent group health and 75 per cent dental premiums paid by Nalcor, while government pays 50 per cent for group health and life insurance premiums only.

On April 23, 2021, the Energy Corporation Act and Hydro Corporation Act, 2007 legislation was amended to allow the Lieutenant-Governor in Council to give direction to boards on matters of remuneration and terms of service and require boards to comply with this direction. As a result of this legislation, and subsequent direction from government (Orders in Council OC2021-127 and OC2021-128), in May 2021, Nalcor eliminated incentive payments for senior management and executive. As well, Nalcor continued to freeze general economic increases for executive and management employees.

In June 2021, Nalcor's former CEO stepped down and a new CEO was appointed. At that time, government announced that Nalcor operations were to move under NL Hydro.

In November 2021, NL Hydro completed an internal reorganization, reducing its executive structure from 18 positions to 11 (10 vice presidents and the CEO). The subsequent elimination of a vice-president's role in April 2022 resulted in the current total executive team complement of 10. The new structure eliminated the executive vice-president and senior vice-president positions, along with adjusted compensation that included the elimination of vehicle allowances and short-term incentives. In total, NL Hydro expects these changes will achieve annual savings of approximately \$2.2 million in executive compensation costs.

In October 2022, NL Hydro eliminated one additional vice-president position. Of the eight vice-president positions in place as of November 2022, actual executive salaries range from \$210,000 to \$285,000. Since accountability, problem-solving, and know-how remain relevant from a classification perspective, they would still be comparable to government executive positions. Those salary ranges still exceed comparable government positions as of July 2022, since the dollar value of the Nalcor pay scales are higher than the pay scales given to government executives. We note that regardless of individual position ratings (accountability, problem-solving and know-how), all vice-president positions have the same salary scale (\$220,000 to \$286,000). Government executive positions are based on their specific position ratings and are not all on the same salary scale.

Conclusions

Overall, Nalcor's management and executive employees' total compensation was, and continues to be, higher than the total compensation of comparable provincial government positions.

Nalcor's executive and management positions had the same accountability, problem-solving, and know-how ratings as equivalent government positions, yet they were paid more money. Nalcor continually increased or broadened salary scales, even after bonuses and incentive programs were removed. Nalcor's executive and management employees receive retiring allowances, higher insurance benefits, and better leave entitlements than government employees. We could not determine any business reason for this variance. It appears salary and benefit levels will not be comparable to government unless changes are made.

Nalcor's compensation for the majority of the positions we reviewed was higher than comparable positions assessed against industry benchmarks. While Nalcor executive and management staff may not have received general economic increases since 2016, the increases to salary levels, pay scales, bonuses and incentives, as well as employee benefits over the past ten years, has resulted in compensation costs higher than government.

The inherent conflict of being a public sector organization that has to compete with the private sector for human resources is a complicating and challenging factor for Nalcor, but also for government. When a public sector entity's salary and benefits practices are more lucrative than others, it creates disparity in the public service, adds to recruitment and retention challenges, and ultimately reduce the public's trust that public money is being managed appropriately.



Recommendation

Compensation Recommendation

Recommendation

Nalcor should re-evaluate its compensation policies and practices to ensure the best possible use of public money, including consideration of alignment with government classification, pay scales, and benefits policies.

Entity Response:

Hydro agrees that its policies and practices should ensure the best use of public money. As a crown utility with a material portion of its operation subject to the Board of Commissioners of Public Utilities and intervening parties' oversight, Hydro is committed to balancing fiscal responsibility while aligning its policies with sound business and good utility practice.

Hydro continues to be responsive and work with Government to evaluate opportunities where appropriate. There have been a number of compensation policy changes implemented since the end of the audit period in 2018. Non-union salary scales have continued to be frozen and many of the compensation elements outlined in the AG report (such as re-earnable cash payments or "bonuses", incentive payments and executive car allowances) have been discontinued, as outlined in the subsequent events portion of the report. In addition, there have been significant changes to Executive compensation since the organization's restructuring in 2021, including reducing the number of Executive positions from 18 to 9 and revising the Executive compensation structure – resulting in significant savings.

As a utility, Hydro has a legislated mandate to provide electrical service in the province and therefore a large portion of Hydro's operations are reviewed on a repeating basis by intervening parties and the Board of Commissioners of Public Utilities. This provides the avenue to assess the appropriateness of Hydro's costs, including labour costs, when considering the ability to act according to industry standard good utility practice in the execution of its mandate. Hydro's compensation policies may not align in every instance with government policy, recognizing the need to remain competitive within the utility market and not compromising safety or reliability in the delivery of least cost electricity.

Appendix I

About this Audit

Why this Audit is Important

We chose to audit Nalcor Energy because it is the province's largest Crown corporation and its operations have been a significant area of public concern in recent years. Our selection of four lines of enquiry were based on routine areas of audit, such as compensation and discretionary expenses, or concerns brought to the Office of the Auditor General, such as conflict of interest and use of embedded contractors.

Employee compensation is the most significant cost for the public service. As a public sector corporation, it is critical that Nalcor pursue a prudent compensation approach to achieve the best possible use of public money on behalf of taxpayers and ratepayers.

Objectives

The objectives of our audit of Nalcor Energy were to determine whether:

1. Nalcor's employee compensation was comparable to government and industry.
2. Nalcor was spending responsibly on discretionary expenses.
3. Nalcor ensured adherence to appropriate conflict of interest policies and procedures, and related legislation.
4. Nalcor was assessing the cost-effectiveness of using embedded contractors when planning and meeting its operational needs.

The first objective is the subject of this report. The other objectives were the subject of our report released on October 6, 2022.

Criteria

The Office of the Auditor General developed criteria based on discussions with Nalcor management, review of relevant documentation, guidelines, legislation, Nalcor policies and procedures, and reviews of literature including reports of other legislative auditors. The Office of the Auditor General defined two criteria regarding the compensation objective. Nalcor's senior management accepted the criteria as suitable.

The Office of the Auditor General assessed whether Nalcor's employee compensation was comparable to provincial government and industry against the following criteria:

1. Nalcor's employee compensation is comparable to provincial government compensation.
2. Nalcor's employee compensation is comparable to industry compensation in similar Canadian regions.

Scope and Approach

Our audit planning began in November 2016 and the audit plan was finalized in March 2018. The audit period covered January 2013 to December 2018. We conducted our audit using a risk-based approach based on our understanding of the entity.

Our audit procedures included informal interviews and discussions with select Nalcor officials and an examination of information and data. Our procedures also included an examination of policies and procedures, correspondence, board meeting minutes, contracts and reports. We conducted a detailed inspection of the information received and analyzed and use the data received to assist with our audit procedures. We performed sampling procedures related to all audit objectives. Sampling selections were non-statistical and selected judgmentally. For this audit report, comparisons were not made with respect to compensation and benefits related to the other types of employees, such as bargaining unit and casual or embedded contractors. All Nalcor subsidiaries were included in this audit report.

Our audit included management and executive positions and excluded positions that are subject to collective agreements. We have included non-management/non-bargaining within the management population.

Appendix I

About this Audit

Audit Standards

This independent assurance report was prepared by the Office of the Auditor General of Newfoundland and Labrador to compare Nalcor's compensation to industry and government. Our responsibility was to independently audit these areas to provide objective information and recommendations. The senior management of Nalcor acknowledged their responsibility for the audit subject matter and the terms of the audit, including audit objectives, scope, and approach.

This audit was performed to a reasonable level of assurance in accordance with the Canadian Standard on Assurance Engagements 3001 – Direct Engagements set out by the Chartered Professional Accountants of Canada and under the authority of the Auditor General Act, 2021.

The Office applies Canadian Standard on Quality Control 1 and, accordingly, maintains a comprehensive system of quality control, including documented policies and procedures regarding ethical requirements, professional standards, and applicable legal and regulatory requirements.

In conducting the audit work, we have complied with the independence and other ethical requirements of the Rules of Professional Conduct of the Association of Chartered Professional Accountants of Newfoundland and Labrador.

Management Representation

The Chief Executive Officer of Newfoundland and Labrador Hydro confirmed that senior management had provided the Office of the Auditor General with all the information they were aware of that had been requested or that could significantly affect the findings or conclusions of the audit report.

Use of Expert

During this audit, the Office of the Auditor General used a compensation benchmarking and evaluation consultant. The Office also used the services of a lawyer specifically to provide general advice and guidance.

Date Conclusion Reached

We obtained sufficient and appropriate audit evidence on which to base our conclusions on November 4, 2022, in St. John's, Newfoundland and Labrador.



DENISE HANRAHAN, CPA, CMA, MBA, ICD.D
Auditor General

Appendix II

Summary of Key Findings and Recommendations from the Nalcor Energy Audit

Discretionary Expenses

Discretionary expenses by their very nature require scrutiny, and oversight is critical to ensuring expenses are necessary, appropriate, and the best use of public money. To assess compliance with policy, we examined a sample of 80 discretionary expenses incurred from January 2013 to December 2018. In general, expenses were approved by Nalcor officials and were within policy spending limits 98 per cent of the time. Generally, discretionary expenses were also within the approval and pre-approval requirements set out in Nalcor's policies.

However, despite having well-defined policies to guide discretionary travel expenses, Nalcor had no policies to guide how hospitality, guest relations, honorariums, and various employee-related expenses were spent. There were also policy gaps for relocation, leased vehicles, as well as board member expense claims. For example:

- In December 2017, a food purchase totalling \$20,027 was made and approved by the same individual for a Christmas dinner in Churchill Falls. This amount was more than \$10,000 above the individual's approval limit.
- In 2014, a claim by one employee for relocation costs totalled \$50,000, significantly higher than what the provincial government would cover. The same employee was also reimbursed for shipping a car at a cost of \$5,000, which was 67 per cent higher than the government limit of \$3,000.
- Nalcor spent an average of \$240,000 annually on employee expenses such as President's awards, social clubs, and service awards.

Our audit specifically assessed discretionary expenses, comparing policies with actions and determining if incurred expenses were reasonable. We compared these policies to those imposed by Treasury Board, since their fiscal stewardship responsibilities would be aligned. There were differences in Nalcor's reimbursement rates as compared to provincial government entitlements. In some cases, Treasury Board would not approve such entitlements. As an example, in 2018, Nalcor's in-province travel reimbursements were 34 per cent higher than what government rates would allow.

Discretionary expense policies that are not consistent across the public sector environment can lead to disparity in the service and the development of corporate cultures that may allow excessive or unreasonable expenses to occur.

Recommendations:

- Nalcor should ensure discretionary expense policies and procedures are clearly defined and include clear spending limits and approval requirements.
- Nalcor should ensure discretionary expenditures are appropriately projected, managed and monitored through the budget approval process and internal control processes.
- Nalcor should manage its discretionary expenses in a manner that ensures the best possible use of public money, by aligning discretionary expenses policy with government policy whenever possible.

Conflict of Interest

Conflict of interest risks are inherent in any organization's operations, and public sector employees, boards, and contractors need to understand organizational expectations and what to do if a conflict should happen. Nalcor's Business Conduct and Ethics Policy outlined its code of conduct in a Business Ethics Handbook, which generally reflected the Conflict of Interest Act. However, there were omissions, including the notion that Nalcor's policies did not provide guidance on accepting post-employment contracts, which is inconsistent with government's policy. We also found that numerous contracts did not contain a conflict of interest section, did not specify termination requirements, had omissions, or ambiguity.

Appendix II

Summary of Key Findings and Recommendations from the Nalcor Energy Audit

For example, we found that the requirement to sign an annual conflict of interest acknowledgment form was not included in Nalcor's online business conduct course and the practice was discontinued between July 2016 and the end of 2018. We performed testing to determine whether 32 contractors, which were actively employed from June 30, 2017, to December 31, 2018, had signed the acknowledgment form. We found that 56 per cent had never completed the form. We also determined that Nalcor did not require contractors to complete acknowledgement forms periodically after their contract date and did not require them to participate in any conflict of interest refresher courses.

We did not find any confirmed incidents of conflict regarding the CEO's employment contract or disclosures.

Public confidence is undermined when conflict of interest policies are incomplete or ambiguous. Employment agreements need to adhere to conflict of interest legislation and an organization's policies and procedures to ensure that any real or perceived conflicts are identified, mitigated and monitored.

Recommendations:

- Nalcor should ensure its conflict of interest policies, procedures, training and guidance documents are clear and comprehensive to make certain that conflict of interest considerations are incorporated into all relevant processes and to ensure employees, board members and embedded contractors know the protocols should they find themselves in a conflict of interest situation.
- Nalcor should ensure it manages and monitors conflict of interest procedures in a complete and timely manner to ensure the procedures are appropriately followed by employees, board members and embedded contractors.

Use of Embedded Contractors

The use of embedded contractors in project management positions requires assessment for cost-effectiveness, particularly if contracts are not short-term in nature, or in situations where embedded contractors may have access to confidential information and the authority to make decisions that could be perceived as a conflict of interest.

We found that Nalcor did not have policies or procedures that required officials to evaluate the cost-effectiveness of hiring employees directly versus hiring a contractor. It appears hiring was exclusively focused on contractors working for the Lower Churchill Project, with no consideration given to creating additional temporary Nalcor positions. While Nalcor asserted that a market for temporary employees on a mega project does not exist, they could not provide evidence to support this comment. Furthermore, we could not find any rationale or documentation to explain why temporary employees were not explored for some positions, such as long-term staff requirements or corporate roles.

For the Lower Churchill Project, contractors worked full-time alongside seconded Nalcor employees and were embedded in the management and decision-making processes for the project. Of the 778 total contractor positions between 2013 and 2020, more than 500 lasted for longer than two years.

There were also areas of inconsistency with respect to the management of embedded contractors, such as the ability to garner detailed information from databases or the termination clauses of agreements. Nalcor had not maintained a comprehensive database of embedded contractor hire history with detailed current and historical costs. For example, Nalcor did not separately track travel, living allowances and reimbursable costs of contractors and, instead, included these costs within the overall contractor labour costs. Nalcor was therefore unable to provide us with a summary or detailed listing of costs for these allowances.

Appendix II

Summary of Key Findings and Recommendations from the Nalcor Energy Audit

Nalcor did not appear to have strong protocols for procuring contractors and managing their costs, nor did they have formal benchmarking processes to determine bill rates. There was no apparent rationale for giving contractors general economic increases, usually only given to employees. For example, in 2017, there were 440 contractors working on project management for the Lower Churchill Project:

- 73 contractors were hired through the lead contractor agreement. Nalcor paid base rates plus bill rate mark-ups, a fixed hourly fee for corporate costs, other overhead charges, and a charge rate to cover office supplies and computer services.
- 299 contractors were hired via recruitment agencies, where Nalcor paid base rates and a percentage per hourly salary rate to cover overhead and recruiting fees. The recruiting fees were up to an additional five per cent above the agency's invoiced hourly cost throughout the entire time that the recruiting agency personnel worked on the Lower Churchill Project.
- 68 contractors were hired directly as independent contractors at stated rates.

For comparison purposes, we considered NL Hydro and their use of embedded contractors, which were mainly in engineering positions. While the hourly rates for these contractors were higher than NL Hydro's salary costs, the rates were significantly lower than what Nalcor paid engineering contractors at the Lower Churchill Project. Officials could not provide us with documentation to show any analysis comparing the costs of contracted corporate positions to the expected costs of temporary employees, inclusive of benefits. Nalcor officials were unable to provide overtime or other compensation details, in order to compile the total cost for each contractor.

We also identified examples of perceived conflicts of interest which illustrate potential opportunities for embedded contractors to benefit personally from their relationship with Nalcor.

Project procurement controls over labour costs are critical. Maintaining a comprehensive database of embedded contractor details can help ensure effective analysis and monitoring. Without this detailed information, there is an increased risk of cost overruns and challenges to understand what decisions were made and why. Consideration of the use of temporary employees, when cost-effective, as well as established processes for assessing, setting and renewing contracts, are two means of managing these project costs.

Recommendations

- Nalcor should ensure it has complete and adequate information to facilitate assessing and monitoring all aspects of project costs pertaining to embedded contractors.
- Nalcor should ensure it has effective procedures and controls over any contractual relationship, including those involving positions of authority, to mitigate the risk and likelihood of conflict of interest.
- Nalcor should ensure it has processes for the staffing of projects, particularly as it relates to assessing the cost-effectiveness of temporary employees versus contractors; consistent contract terms for allowances; and the continuous management of staffing mix and cost.

Compensation

Compensation paid to Nalcor executive employees was comprised of base salaries, salary increases, incentive payments and benefits. Compensation paid to Nalcor management employees consisted of base salaries, salary increases, bonuses and employee benefits. Using the provincial government as a comparison, compensation paid to management and executive consisted of base salaries, salary increases and benefits. Nalcor's compensation expense for the calendar year 2018 was \$180.5 million, which was comprised of \$90.9 million for 950 management employees, \$84.8 million for bargaining unit employees, and \$4.8 million for 17 executive employees.

Appendix II

Summary of Key Findings and Recommendations from the Nalcor Energy Audit

We found that Nalcor paid significantly higher total compensation as compared to the provincial government for all 35 management and executive positions we examined. While the assessment of accountability, problem-solving, and know-how were the same, the comparable government positions had lower salary pay scales. We could not determine any business reason why there were such significant differences in the pay scales.

Of the 35 positions we examined, all had base salaries higher than comparable government base salaries; the addition of Nalcor bonuses, incentives and greater employee benefits increased the disparity between Nalcor and government.

Nalcor employees were compensated at increasingly higher base rates during our audit scope period. Nalcor's Board of Directors also approved the implementation of executive salary scales effective April 1, 2017, which were higher than prior employment contract base salary levels. These new salary scales allowed the maximum base salary level to be 120 per cent of the pay scale. In November 2017, Nalcor's board approved further revisions to the executive vice-president pay scales, effective April 1, 2018. The executive vice-president positions received an additional 14.5 per cent increase, without any change in the accountability, problem solving, or know-how of their positions. A new management salary structure was approved by the board in 2018, which had broader pay ranges to replace bonus payments, which were being eliminated, and allowed management employees to progress beyond the top of the scale by 10 per cent. For context, these changes happened when provincial government employees were under a pay freeze.

There were approximately 15 executive employees given an average of \$46,000 each in incentive payments annually from 2013 to 2018. There were approximately 70 senior management employees given an average of \$16,000 each annually in incentive payments in lieu of bonuses during the scope of our audit. As well, from 2013 to 2018, Nalcor paid approximately \$1.5 million in bonuses to management employees who were at the top of their pay scale. In the provincial government, step increments do not normally go beyond the top of the scale and government does not provide salary adjustments or bonuses as a form of compensation for performance.

We found significant differences between the benefits package Nalcor offered its employees and the benefits package offered by government. Nalcor paid 100 per cent of its employees group health and life insurance premiums and 75 per cent of dental plan premiums; government paid 50 per cent for group health and life insurance premiums and nothing toward dental plan premiums.

Nalcor provided car allowances to its entire executive team worth \$12,740 each in a taxable car allowance annually (\$490 biweekly) or assigned a fleet vehicle for exclusive use with a fleet gas card. In comparison, government generally does not provide car allowances to executive staff, instead offering mileage reimbursement for work-related travel. Nalcor paid a retiring allowance of up to a maximum of 26 weeks' salary based on up to 26 years of completed service, while government ended its 20 weeks salary severance policy in May 2018. Nalcor's total paid leave entitlements when combined, could provide up to 108 paid leave days annually, all at the employer's cost. By comparison, provincial government management employees receive between 25 and 35 paid leave days annually, depending on years of service.

We found that Nalcor's base salaries were above many of the benchmarks found in the industry. Specifically, we found that executive employee total compensation was at the high end of the range of Canadian industry markets. Management employee total compensation was also above Nalcor's benchmark of the Atlantic Canada electric utilities market. While we were unable to compare many aspects of Nalcor management or executive benefits against industry benchmarks due to a lack of comparable data, we did note that the value of offering a defined benefit pension plan resulted in above-industry benefits for Nalcor employees.

Appendix II

Summary of Key Findings and Recommendations from the Nalcor Energy Audit

Nalcor's executive base salaries were above both the utilities and industrial market benchmarks for their executive vice-presidents and both levels of vice-presidents. The compensation market review found that Nalcor's base salary for almost all (27 of the 30) of the benchmark management positions were above the market median of the Atlantic Canada utilities market. From 2013 to 2018, management employees progressed within their base salary scales annually as a result of receiving increases ranging from four to eight per cent, depending on the result of performance evaluations. In comparison, we found that Canadian compensation planning surveys reported average increases ranging from 0.3 per cent to 4.4 per cent.

Recommendation:

- Nalcor should re-evaluate its compensation policies and practices to ensure the best possible use of public money, including consideration of alignment with government classification, pay scales, and benefits policies.

About Us

Vision

Promoting positive change and accountability in the public sector through impactful audits.

Mission

To promote accountability in government's management and use of public resources and encourage positive change in its delivery of programs and services.

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Above all else, the Office of the Auditor General must have independence, credibility and integrity. These are essential to everything we do; critical to our success. The Office of the Auditor General complies with professional and office standards to produce relevant and reliable audit reports. The Office of the Auditor General's independence of government, in fact, and in appearance, provides objective conclusions, opinions and recommendations on the operations of government and crown agencies. Our staff work in a professional and ethical manner, ensuring respect, objectivity, trust, honesty and fairness.

Audit Team

The Auditor General wishes to thank the diligent audit team who performed their work with independence, credibility, and integrity:

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