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Report operational audit TelEm NV

21/0425C/CL

September 3, 2021

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To the Supervisory Board of the St. Maarten Telecommunication Holding Company N.V.
Attn. The Chairman
Soualiga Road 5
Sint Maarten

Philipsburg, September 3, 2021

Number : 21/0425C/CL
Reference : drs. R.N. Sandriman RA/ drs. C.B. Joseph RO EMIA
Subject : Audit report Operational Audit St. Maarten Telecommunications Holding Company N.V.

Dear Sirs,

We have carried out our operational audit with regard to the St. Maarten Telecommunication Holding Company N.V. (TelEm Group) as defined in our confirmation letter of October 13, 2020. This report contains the results of this work. We would like to thank the members of the Management Board, the Supervisory Board and other staff-members that have made this audit possible by providing the necessary information and documentation.

1. Audit objectives

The goal of this operational audit is to provide the Board with insight to the extent to which the internal measures and internal control systems the TelEm Group have in place at strategic level are effective, in order to secure the achievement of its goals and the compliance regarding the following areas:

1. The effectiveness of the management control in general.
2. Analyses of financial results of the last 5 years (2015-2019) and efficiency control measurements.
3. The effectiveness of the communication (structure and content) within and between Management (the Board of Directors) and the Board.
4. The effectiveness and efficiency of the decision-making process regarding investment projects and project management in general, and some selected big investments of the last 5 years.
5. The capacity (quantitative and qualitative) of Management (the Board of Directors).
6. Effectiveness of the internal audit department and compliance of the internal audit department with international standards for internal auditing.

1.1. Operational audit

Through an operational audit the functioning of an organization or part of it can be examined, hereby enabling the organization to improve its efficiency and effectiveness in achieving its strategic goals. Effectiveness is how well a process accomplishes its objective. Efficiency is how well or cost effective a process turns inputs into outputs. Identified issues are tested against a standard or existing norm.

Operational audits can focus on the functioning of the strategic level, the tactical level and/or the operational level. Also, the audit can be focused on identifying issues, analyzing the cause of the issues or solving the issues. The focus of an audit is indicated by the client in consultation with the auditor. Depending on the existence of an internal norm within the organization, the issue identified can be held against that norm, or a common accepted norm is used. We would like to state explicitly that operational audits are not designed to detect fraud.

2. Nature and scope of the work

This engagement was executed in accordance with the fundamental principles of integrity, objectivity, confidentiality, professional behavior, professional competence and due care as promulgated by the Code of Ethics of the Netherlands Association of Accountants ('NBA'). This engagement does not constitute the execution of audit or review activities with the aim of issuing an audit opinion or a review opinion on financial information. As a consequence, the guidelines and regulations concerning audit and assurance engagements ('NV-COS') of the NBA are not applicable to this engagement.

3. D Description of work carried out

In order to answer the research questions, it first was established whether standard frameworks were available for reference purposes. Where possible the COSO-framework has been applied.

Document research

Our audit commenced with the analysis of documentation provided by your organization. These documents concern but are not limited to: strategic plans, operational plans, projects documentation, annual reports, management reports, policies and procedures, meeting minutes and resumes. Your company has been very helpful in providing the requested documentation.

Analytical and part observations

The provided documentation was used for the initial analysis of the effectiveness of internal controls at a strategic level. Based on the analysis performed additional information and documentation was requested.

Interviews

To get a better understanding of the methods of operation and the control and accountability in practice, ten (10) interviews were conducted including members of the Management and Supervisory Board.

Research period

The agreed upon research period was 2015 to 2019. When deemed appropriate we (additionally) obtained more recent information.
The results of the research will be reported in the following chapter.

Communication of results

Our research activities were performed in the period between December 1, 2020 and March 31, 2021. Our draft report was issued for feedback to the Management Board as per April 12th, 2021. Subsequently the draft report including the (processed) feedback of the Management Board was issued for feedback to the Supervisory Board of Directors per May 31, 2021. Final feedback of the SBOD was obtained on August 1, 2021.

The received responses from both the Management Board and the Supervisory Board have been incorporated in the report when information in the draft-report appeared incorrect, or when additional information or documentation was provided to alter the content of the initial findings in the report.

4. Observations

In this chapter of the report we summarize the main observations made during our audit. The risks associated with these observations are indicated as well as some guidance regarding the way in which these risks can be mitigated.

We have observed a Management Board trying to guide TelEm through a very difficult period. A broken submarine cable, hurricane Irma, the take-over of UTS by Liberty Global, the constant and increasing need to invest to keep up with technical developments and of course the Covid-pandemic have made it challenging to keep the company on the right track. Especially under these difficult circumstances it is essential that the Management Board and Supervisory Board work together in a constructive manner, each with their own specific tasks and responsibilities. Unfortunately, we must conclude that the relationship between the Supervisory Board and the Management Board has not always been that constructive, adding to the overall difficulty to keep TelEm on track. The upcoming change in composition of the Supervisory Board may provide a new opportunity to collaborate in a positive manner. Internal control is an important part of the overall corporate governance structure of TelEm, and good governance starts with the right tone at the top.

The objective of our audit was to provide insight into the effectiveness of internal control measures at a strategic level. Therefor we report the issues found regarding the effectiveness. Because of the confidential nature of the information provided to us during the audit, our observations are formulated at a higher abstraction level with little reference to more detailed information. When discussing our observations with the Management Board and the Supervisory Board additional support for our observations was provided when requested.

As indicated in §1.1 an operational audit, especially at a strategic level, is not designed to detect fraud. However, when indications of fraudulent behavior would have been observed, this would have been brought to the attention of the Supervisory Board. This has not been the case during our audit.

The observations and proposed solutions can be used to further improve the internal controls at strategic level within TelEm. Since some of our observations relate to the Supervisory Board, this should preferably be a joint effort between the Management Board and the Supervisory Board.

Our observations are grouped in accordance with the research topics of the audit:

1. The effectiveness of the management control in general.
2. Analyses of financial results of the last 5 years (2015-2019) and efficiency control measurements.
3. The effectiveness of the communication (structure and content) within and between Management (the Board of Directors) and the Board.
4. The effectiveness and efficiency of the decision-making process regarding investment projects and project management in general, and some selected big investments of the last 5 years.
5. The capacity (quantitative and qualitative) of Management (the Board of Directors).

6. **Effectiveness of the internal audit department and compliance of the internal audit department with international standards for internal auditing.**

4.1. The effectiveness of the management control in general

4.1.1. Limited involvement of the Supervisory Board in the definition of the strategic plan

Observation

In 2018 the Management Board took the initiative to establish a strategic plan covering the 2019-2023 period. The compilation of the strategic plan was performed with the support of an external consultant. The Supervisory Board was not consulted during this process nor did they approve the strategic plan. The management Board presented the Strategic plan to the Supervisory Board and submitted a copy of the strategic plan to the Supervisory Board. While it is positive that the Management Board took its responsibility to compile the strategic plan, according to Corporate Governance best practices it remains the responsibility of the Supervisory Board to advise on, review and approve the strategic direction.

Risk

The limited involvement of the Supervisory Board in the definition of the strategic plan prohibits the Supervisory Board from providing their input and share concerns and perceived risks about the proposed strategic direction of the company. When management and the board do not share the same vision on the strategic direction of the company, this may hamper the effectiveness of the oversight role and reduce the company's overall performance.

Proposed solution

The Supervisory Board should be consulted when the strategic direction of the company is determined. This creates common goals for management and the board to achieve. A formal approval of the board should be obtained prior to the execution of the strategic plan. Being almost halfway down the 5-year period of the strategic plan, a review and update of the strategic plan may be considered.

Management response

The Supervisory Board indeed was not involved during the compilation of the strategic plan, but they were given the opportunity to provide their feedback on the strategic plan when it was presented.

4.1.2. The translation of the strategic plan to operational goalsetting has not been realized completely

Observation

The strategic plan includes detailed actions and timelines. The task of the Management Board is to assign responsibilities for the execution of all elements of the strategic plan in order to realize the perceived benefits of the strategic plan. While most elements of the strategic plan are in the process of execution, other parts of the strategic plan have not been executed nor assigned.

Risk

A strategic plan is developed as a coherent set of actions and goals to achieve the company's strategic objectives. When certain parts of the plan are not assigned to an action holder nor executed this may negatively impact the achievement of the company's goals.

Proposed solution

Assign all actions that are still relevant for the achievement of the company's strategic goals and have not been assigned yet to an action holder, to a responsible person.

Management response

All actions of the strategic plan have been assigned to responsible managers. We are aware that we can improve on the execution.

4.1.3. The realization of strategic goals is not monitored in a structured manner

Observation

At the end of 2018 the strategic plan was established covering the 2019-2023 period, as mentioned prior. The strategic plan includes detailed actions and timelines. On a monthly basis a balance sheet and profit & loss are prepared to monitor the financial position of the company. Management however did not deploy a reporting and monitoring plan including key financial and operational KPI's to effectively monitor the progress of implementation of the actions derived from the strategic plan.

Risk

The risk of not establishing a complete reporting and monitoring structure is that management cannot effectively track the execution of the strategic plan. This may result in the strategic plan being not or not completely executed as planned.

Proposed solution

Establish a reporting and monitoring structure that includes all the aspects of the strategic plan and includes key financial and operational KPI's. These reports can also be used to inform the Supervisory Board about the progress in realization of strategic initiatives.

Management response

While there is no formal reporting structure deployed, Management does monitor the progress in a more practical manner.

4.1.4. Financial reporting versus management accounting: Lack of steering information

Observation

On a monthly basis a balance sheet and profit & loss account are compiled and sent to both the Management Board and the Supervisory Board. Though this provides management with insight into the financial position of the company, this is not considered complete 'steering information' in terms of the realization of operational objectives. When e.g. goals are set by the commercial department to increase revenues generated by certain products, or part of the year plan of the technical department indicates that certain technical upgrades will be performed, periodic management reports should support the monitoring of the realization of these goals. This provides the Management Board the opportunity to take corrective measures in a timely manner. Progress reports provided indicate a lack of 'linkage' in various areas between (strategic) goalsetting and progress monitoring and linkage of goals between departments. Additionally, goalsetting especially regarding technical projects lacks strict deadlines.

Finally, an analysis of deviations from defined goals as well as corrective actions are not included in the progress reports.

Risk

When goals are not defined in a 'SMART'[1] manner this complicates the monitoring of progress of the achievement of these goals. In case no deadline is determined for a specific project ('Time-bound'), management is not able to identify delays in the execution in a timely manner.
Without proper steering information, management cannot effectively monitor the realization of operational goals and act accordingly.

Proposed solution

Setup a new periodic management reporting structure based on the information needs indicated by the Management and Supervisory Board and based on the strategic and ('SMART') operational goals set for the various departments.

4.1.5. Risks related to the achievement of the company's objectives are not managed in a structured manner

Observation

A structured risk management approach is an essential part of effective management control. Management has emerged on the path of implementing risk management. An effective risk management approach should consider risks related to the achievement of the company's objectives. This structure has not been implemented yet. Instead a more generic risk assessment approach was applied.

Risk

When risks are not assessed based on the objectives established by the company but in a more generic way, risk mitigation may be applied in areas with little value to the achievement of the company's objectives while relevant risks may be overlooked. It could also result in proceeding too long with non-profitable projects or activities.

Proposed solution

Apply a structured approach to risk management where risks are assessed and mitigated based on the company's objectives.

4.1.6. The impact of the Supervisory Board on the effectiveness of management control

Observation

An assessment of the effectiveness of the Supervisory Board was not part of the scope of the assignment. There is however a strong relation between the effectiveness of management control in general and the manner in which the oversight and advisory role of the Supervisory Board is executed. Therefore, the aspects regarding the Supervisory Board that may impact the effectiveness of management control in general are listed below:

- The Supervisory Board only consists of 2 members as per April 1st while the articles of incorporation indicate a minimum of 5 members.
- The Supervisory Board did not formally confirm the strategic direction of TelEm and did not indicate their information needs to management to monitor the realization of strategic initiatives.

[1] Specific, Measurable, Achievable, Relevant and Time-bound.

- The Supervisory Board meets with a very high frequency (up to > 40 times per year) which imposes the risk of losing strategic focus and interfering with the (operational) responsibilities of management.
- No goalsetting nor evaluation of management has been performed since 2018.
- A meeting schedule / planning with topics to cover during the meetings was compiled for 2020 but not adhered to, resulting in critical activities not being executed.

Risk

Ineffective oversight may hamper the effectiveness of management in realizing the strategic objectives. Additionally, it prevents the Supervisory Board from contributing to the strategic direction of the company and effectively monitor the realization of TelEm's strategic objectives. Constructive collaboration between the Supervisory Board and management is key to strategy realization.

Proposed solution

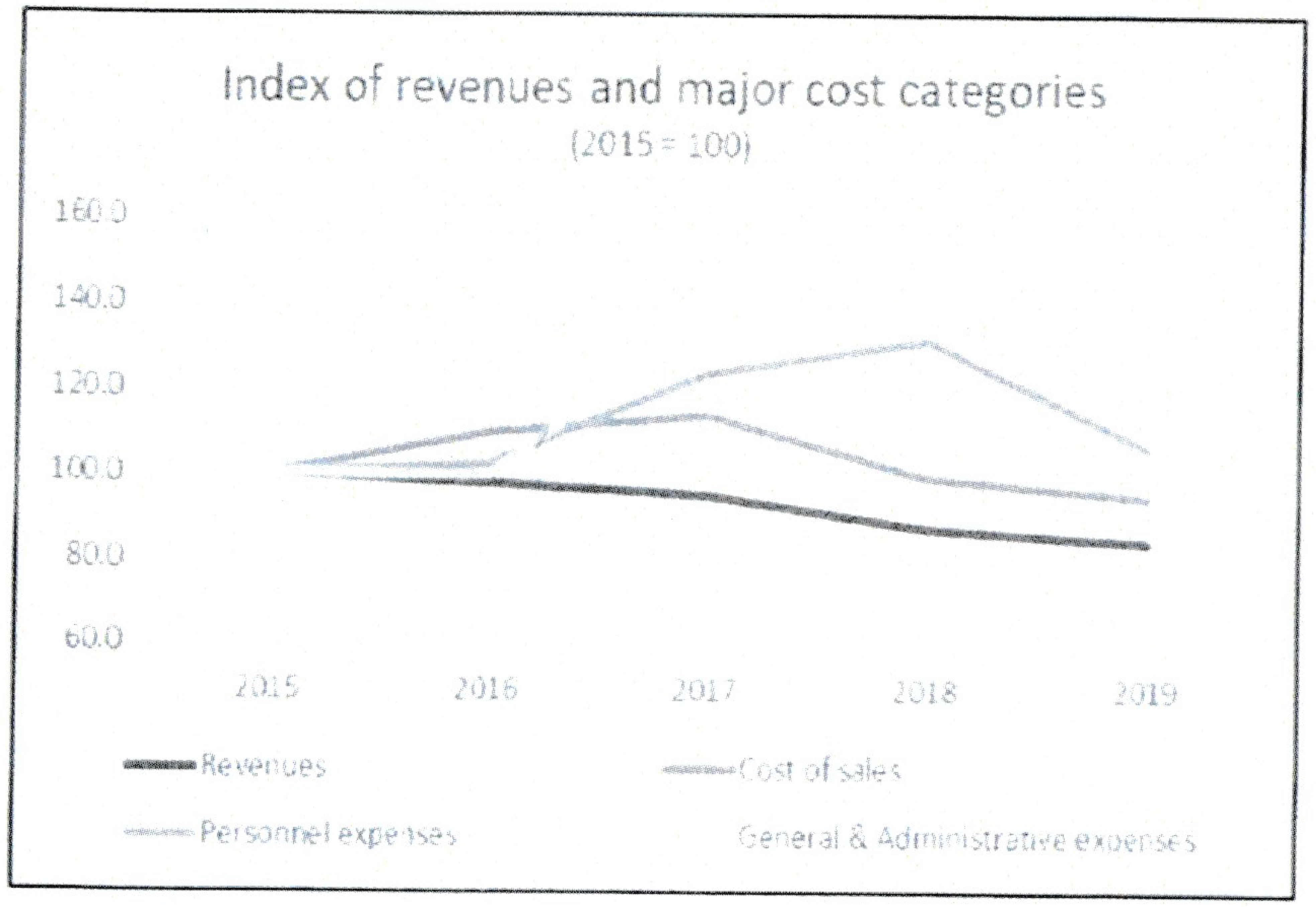
Supplementation of the Supervisory Board to at least the statutory minimum of 5 members must be arranged on short notice, preferably based on profiles compiled by the Supervisory Board indicating the necessary skills and knowledge. A clear definition of the roles, responsibilities, expectations and information requirements of the Management Board and the Supervisory Board needs to be established and adhered to. The Supervisory Board needs to formally confirm the strategic direction of TelEm and indicate its information needs to the Management Board. The frequency and length of Supervisory Board meetings should be in line with the strategic focus of the Supervisory Board. Goalsetting and evaluation of the Management Board will be performed in a structured manner. A meeting schedule should be established and adhered to including the topics that will (at least) be covered during these meetings.

4.2. Analysis of financial results of the last 5 years (2015-2019) and efficiency control measures

4.2.1. Reported profits are shifting and structurally decreasing

Observation

As will be further explained in §4.2.3, TelEm experiences a shift in turnover from 'voice' to 'data'. Unfortunately, the increase in turnover from data is insufficient to compensate for the loss in revenue of voice. The direct and indirect cost of sales did not decrease at the same speed hereby reducing the gross margin. Additionally, management did not succeed in reducing the two major cost categories: Personnel expenses and General & Administrative (G&A) expenses sufficiently to compensate for the loss in gross margin. In the diagram below the development of revenue and cost are visualized.



For 2021 TelEm did formulate a commercial plan aiming at significantly increasing revenues.

Risk

TelEm needs to maintain certain financial ratio's due to external financing, after the expiration of the Moratorium Period that will last until August 2022. Defaulting on the conditions set in the loan agreement may increase the risk profile of the loan and have a negative impact on the loan conditions.

Proposed solution

In conjunction with §4.2.3 TelEm needs to review its cost structure since the developments of major cost categories are not in sync with the declining trend of the turnover. Aggressive commercial plans to boost sales may contribute to the overall profitability but should be executed in parallel with the necessary cost reductions.

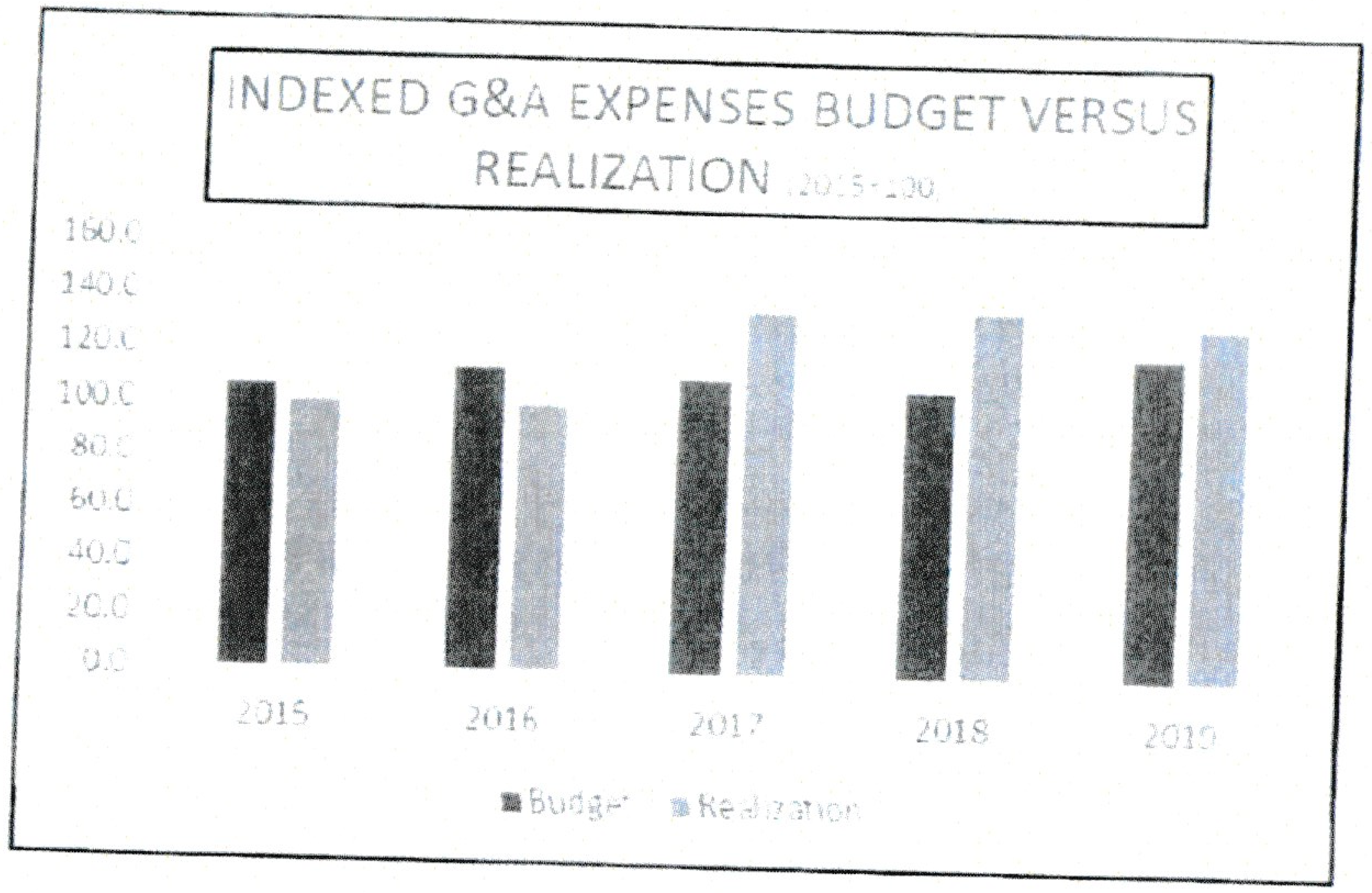
Management response

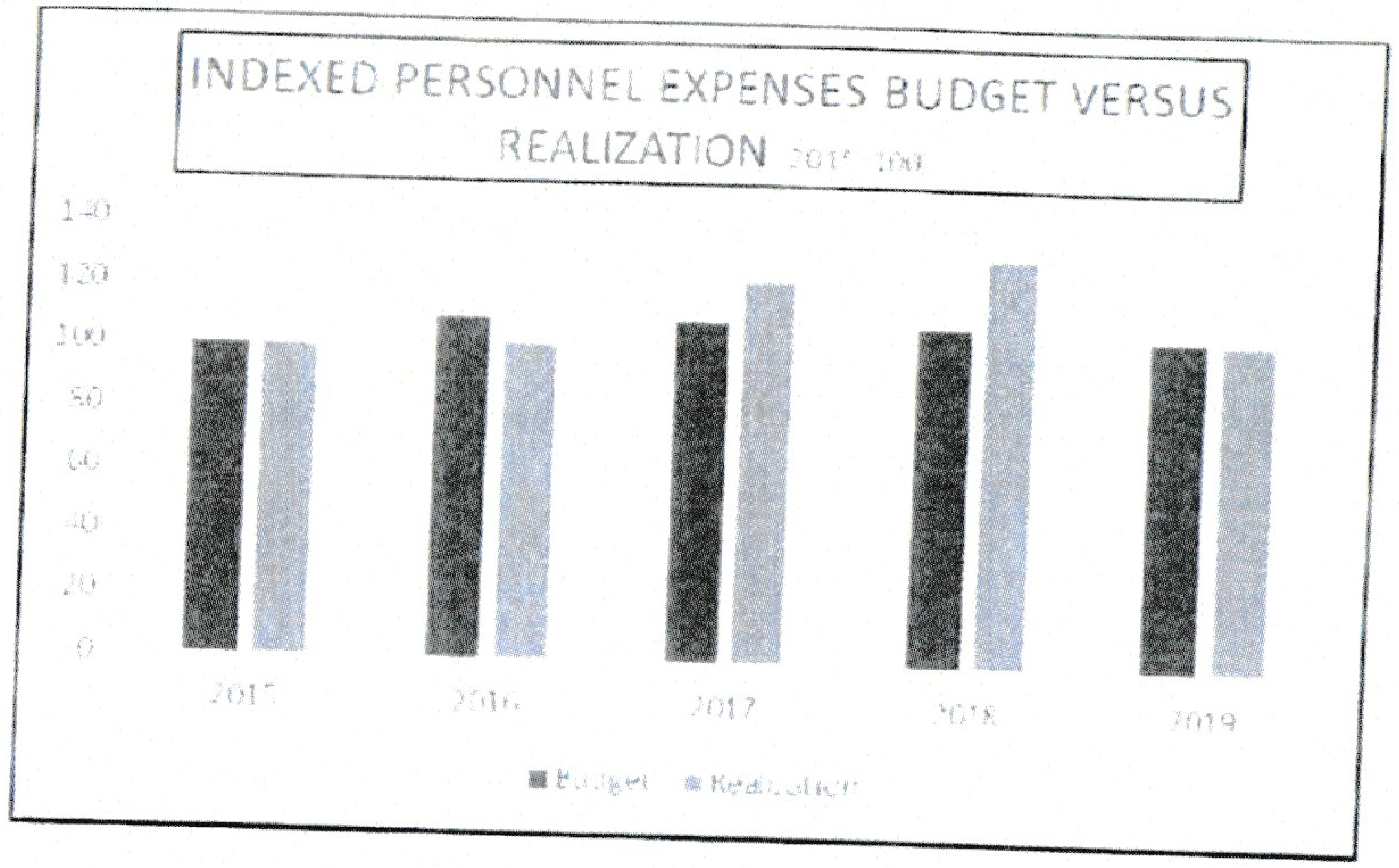
Overhead cost by nature do not follow revenue trends. Increasing revenues requires investments.

4.2.2. Structural overruns in G&A expenses

Observation

With respect to G&A expenses it is visible that since 2017 there have been significant budget overruns. In 2017 this was partly due to 'hurricane expenses' while in 2018 an increase in consulting and insurance cost maintained the G&A expenses at the same increased level. In 2019 the increased insurance cost remained, despite comparison with quotations of other insurance companies. While consulting expenses were reduced, the cost for software support however significantly increased.





The lower overrun on G&A expenses in 2019 can mainly be contributed to the increase of the 2019 budget.

A similar analysis was made for personnel expenses over the 2015-2019 period.

The higher personnel expenses in 2017 are partly due to the cost related to the severance package of former SXM cable company employees. In 2018 the change in pension plan for TelEm employees from defined benefit to defined contribution resulted in a significant one-time expense. The personnel expenses in 2019 are just 5,5% higher than 2015 however given the decrease in revenues of close to 20% over the same period the employee expenses absorb an increasing part of TelEm's gross margin.

Risk

Budget control is essential in a company with decreasing profit margins. Significant deviations from budget further decreases the overall profitability of the company.

Proposed solution

Include all plans for the upcoming year into the budget and strictly adhere to approved budgets. Actively mitigate risks that may negatively influence budgeted cost levels.

Management response

More products and network elements were added to the companies' portfolio resulting in increased software support and vendor maintenance contracts. The operations were also changed to make use of more Managed services (leading to less needed inhouse manpower and expertise) which is a trend in the telecom Industry. The cost structure was reviewed several times and updated where needed.

4.2.3. Limited insight into the actual cost and revenue drivers

Observation

Due to technology changes and changes in market demand, the turnover related to 'voice' has been gradually decreasing for a number of years while the turnover related to 'data' has been increasing. The increasing speed of technology changes additionally puts a burden of ongoing investment needs on TelEm. The replacement of the copper and coax network by fiber is currently by far the biggest investment project. Given the structural change in composition of the turnover, insight in the cost related to the products offered by the company may help to increase profit margins and making overhead decisions. The review of the overall cost structure of the company is also part of the strategic plan. An effort has been made to allocate cost to the different product lines, however this exercise has not been finalized and this information is not (yet) used as input for a strategic cost structure review nor for commercial product development. Also, for the shareholder it is essential to have insight into the effect of the shift from voice to data on the long-term profitability of the company.

Risk

Without insight into the cost of products sold, the company may invest in products that provide limited profitability. It may also lead to cutting cost in areas that contribute to the overall profitability of the company.

Proposed solution

Complete the cost allocation initiative, possibly with professional external support, to determine the profitability of the portfolio of products and services and use this data for a strategic review of the overall cost and perhaps organizational structure of the company and as a basis for commercial product development and pricing policies.

Management response

The cost allocation has been completed. The company adjusted its business-model and provided many projections to ensure viability in the future. The shareholder received presentations to discuss the effect of this shift and how the company will adjust its strategy to survive.

4.2.4. Unauthorized payment

Observation

We noted one instance where management has made disbursements while the nature of the payment required prior approval of the supervisory board. In this case the supervisory board has instructed management to reverse the payment. In another case there has been discussion about the legitimacy of a payment without Supervisory Board approval due to the amount involved.

However, the articles of incorporation indicate that as long as the expenses fall within the approved budget, no additional Supervisory Board approval is required. The monetary limits over which Supervisory Board approval is required are set to facilitate the Supervisory Board in executing their oversight role, including cost control on behalf of the shareholder.

Risk

Failure to adhere to internal procedures may hamper the effectiveness of the Supervisory Board and additionally create distrust between both boards.

Proposed solution

Adherence to internal procedures is essential to build trust and facilitate boards to effectively execute their duties. When there is a difference of opinion about the necessity or application of certain procedures, this needs to be discussed and adapted when applicable.

4.3. The effectiveness of the communication (structure and content) within and between the management team and the Supervisory Board

4.3.1. High frequency of Board meetings

Observation

Management Board

Concerning the periodicity of meetings, the articles of association prescribe that the Management Board meet as often as one of the Directors deemed necessary, but at least once a month (article 9, section 2), so at least 12 times a year.

Members of the Management Board indicated that they meet three (3) times a week for two (2) hours (on Monday, Wednesday and Friday from 10 to 12). That is approximately twelve (12) times a month and hundred and forty-four (144) times a year. In 2020, the Managing Board had an even higher frequency of meetings due to the COVID Pandemic. In March and April 2020, the Management board had daily meetings discussing the practical measurements at that time, like having staff working from home. An increase in the number of meetings is justified and even recommended in times of crisis.

Supervisory Board

The stipulation in the articles of association for the Supervisory Board is at least once a quartile (article 12, section 12), that means at least four (4) times a year.

Members of the Supervisory Board indicated that their board has meeting officially twice a month, once a month with the Management board and once the Supervisory board alone but sometimes there were more, for example extraordinary meetings. In 2019 the Supervisory Board met 43 times in total.

Risk

When the frequency of Management Board meetings exceeds a certain threshold, the risk is that it becomes inefficient as the content becomes too operational and board members get involved into the areas of delegated tasks and responsibility of another board member.

When the frequency of Supervisory Board meetings exceeds a certain threshold, the risk is that the Supervisory Board gets too much involved into the responsibilities of the Management Board, such as daily operations.

Proposed solution
The frequency of Management Board meetings should be determined at a level considering the responsibilities of individual board members.
The frequency of Supervisory Board meetings should be determined at a level commensurate with the purpose and the role and function of the board.

Management response
The high frequency of Management Board meetings in the period under review was mainly due to the COVID-crisis at hand. Meetings are currently down to once a week and are usually finished within the hour.

4.3.2. Operational content of board meetings

Observation
As indicated in §4.3.1 a high frequency of board meetings may have a negative impact on the overall effectiveness of the meetings. A review of a sample of meeting-minutes indeed confirmed the operational nature of the topics and/or level of detail discussed in both Supervisory Board and Management Board meetings.

Risk
In addition to the risks indicated in? §4.3.1, the amount of time spent on preparing and attending board meetings may affect the amount of time available for actual strategy realization in a negative way.

Proposed solution
The Management Board evaluates the effectiveness of the current frequency of board meetings. The Supervisory Board assigns a predefined amount of time of each meeting on strategic topics and topics that are part of the annual agenda and sets a fixed timeframe for the meeting. An effective reporting structure as proposed in §4.2.3 may help to maintain the content of the meetings focused and on the right level.

4.3.3. Follow-up of decision making can be improved

Observation
During the meetings of both boards, (Management Board and Supervisory Board) decisions are made and actions are defined. These decisions and actions are noted in the meeting minutes. The actions are assigned to a person responsible but generally no due-date is determined. Additionally, only periodically list of open actions is maintained as part of the minutes for follow-up purposes.

Risk
When decisions and actions are not followed-up in a timely and structured manner, the decisions may not be (timely) implemented and objectives not be achieved. This also adds to the ineffectiveness of the (frequent) board meetings.

Proposed solution
For each meeting a standardized list of actions and decisions is compiled including persons responsible and due dates. The action list with open items is the first topic on the agenda of the next meeting.

Management response
In the Management Board, due dates are assigned to each action though they may not always be adhered to. Periodically the list of open actions is discussed.

4.4. The effectiveness and efficiency of the decision-making process regarding investment projects and project management in general and some selected big investments of the last 5 years (2015-2019)

4.4.1. Business cases are not effectively managed

Observation

Important projects are not (always) based on an existing and positive business case. A business case should provide the possibility for management to make an investment decision based on projected costs and revenues and other projected gains. In case a project experiences serious delays or circumstances change that have an impact on the initial business case, the business case should be updated to reflect the most current projections of expected benefits. Current projections of revenues are made at an aggregated level but not specifically to reflect the benefits of the investment project.

Risk

When a project is initiated without a positive business case, investments may be made that will not provide the expected return to the company. When the business case is not updated regularly, the company may not adapt their strategy in a timely manner and continue (too long) to invest in a project that no longer provides a return for the company.

iProposed solution

Only start with the execution of a project when a positive business case is presented by the project manager. Actively manage the business case to assure that ongoing investment projects will continue to provide a return for the company also when circumstances have changed.

Management response

A positive business case is not always needed e.g. in the case of a new billing system or upgrade of existing technologies that are needed for strategic reasons to maintain market share. In some cases the company will proceed even if the business case is negative. Management does not update the business case, instead the project budget is monitored as well as deliverables.

4.5. The capacity (quantitative and qualitative) of the management team

4.5.1. Structure of the Management Board not in line with the articles of incorporation

Observation

According to article 7 of the company's articles of association the Managing Board should consist of two statutory directors, namely a Chief Executive Officer, (hereinafter CEO) and a Chief Financial Officer (hereinafter CFO). "The CEO and the CFO are assisted by one or more company directors, which have to be appointed by the Management Board after approval of the Supervisory Board. Those company directors can get titles such as Chief Operations Officer (COO), Chief Human Resource and IT Officer (CHIO) and Chief Commercial Officer (CCO)". The actual Management Board consists of a CEO and a CFO as statutory directors and a Chief Technical Officer (hereinafter CTO) and a CCO as company directors.

The Management Board indicated that the technical character of the company is the reason for appointing a CTO instead of the proposed CHIO in the Statutes. The Management Board stated further that the HR and IT functions fall under the responsibility of the CEO and in that way the portfolio is divided over all C's. So technical under CTO, Finance under CFO, Commercial under CCO and HR/IT under CEO.

The articles of incorporation date back to 2010, therefore a deviation from the structure defined at that time also considering the current size of the company, may be justified.

Risk

A misalignment between the organizational structure and the strategic objectives of the company may have a negative impact on the company achieving those objectives.

Proposed solution

An evaluation of the current organizational structure is performed as part of the strategic plan. The capabilities of the individual board members should be considered in this evaluation and roles and responsibilities adjusted accordingly. When the current structure is maintained, the articles of incorporation should be updated to reflect the actual situation.

Management response

The organizational structure was aligned with the strategic objectives in 2010 during the restructuring of the company. In recent years this was reviewed and discussed and updated with changes that were needed in the technical division and commercial division.

4.5.2. Compliance with the formal job requirements

Observation

The members of the Management Board are selected based on formalized job requirements. Relevant knowledge, experience and skills are required to perform the responsibilities of the Management Board in an optimal manner. Though in general the members of the Management Board comply with the relevant requirements, this is not the case for all of the members of the Management Board.

Risk

When a board member is appointed who lacks some of the requirements necessary for the position this creates the risk of disbalance within the board and the company not achieving its objectives in various ways.

Proposed solution

The Supervisory Board identifies the remaining gaps (or hires a competent party to do so) between the job requirements and the actual knowledge, experience and skills of the individual board members. Together with the board member a personal development plan is defined with interventions necessary to resolve these gaps. This may include a more active monitoring role of the Supervisory Board itself.

Management response

An executive leadership program is part of the strategic plan. This has been postponed as no travel was allowed and no budget was available due to Covid-19.

4.5.3. Ineffective goalsetting and evaluation of the Management Board

Observation

The results of TelEm are declining. As indicated in the introduction of this chapter there have been various external factors that have influenced the performance of TelEm in a negative manner. The Supervisory Board has not always been satisfied with the performance of the Management Board. It is the responsibility of the Supervisory Board to determine the goals for the Management Board hereby setting the standard for their individual and team performance. Goalsetting and performance evaluation are important to align the personal goals with the strategic objectives of the company and may also serve as a basis for variable compensation. Since 2019 the Supervisory Board has not conducted a formal performance evaluation of the Management Board members.

Risk

When goals for the Management Board members are not defined and agreed upon on an annual basis, it may hamper the possibility of performance evaluation and further development. It may also create the risk of management not executing the activities necessary to realize the strategic objectives.

Proposed solution

The Supervisory Board annually determines performance goals for Management. These goals are linked to the short-term and long-term objectives of the company and relate directly to the areas of responsibility of the individual board members and the Management Board as a whole. Additionally, personal development goals may be included. Periodically the performance of management is evaluated against these goals and serve as a basis for variable compensation.

4.6. Effectiveness of the internal audit department and compliance of the internal audit department with internal standards for internal auditing

4.6.1. The internal audit department is not used to its full potential

Observation

The audit-charter of the internal audit department indicates that the department provides assurance regarding:

- Effective, efficient and secure business operations
- Safeguarding of the companies assets
- Reliability and integrity of business and financial data and reporting
- Compliance with applicable Cooperate Governance Code for government owned enterprises, laws and regulations including internal plans, procedures and general policies
- Business objectives

This in line with the purpose of an internal audit department in general. In practice the annual audit plan exists almost entirely of audit activities supporting the annual financial statements audit by the external auditor.

Although this limited use of the internal audit department is more an internal choice of TelEm, it constrains the independent risk-based planning of audits by the department and thus limits "themed" audits and audits of possible irregularities outside the scope of the financial audit. Use of a risk-based audit year plan is in line with the quality standards of the Institute of Internal Auditors (IIA).

Risk

When the internal audit department is only used to support the financial statements audit, risks in other of the above-mentioned areas may remain undetected resulting in organizational objectives not being achieved.

Proposed solution

TelEm could benefit from a more diversified risk based annual audit plan where the assurance and consulting role of the internal audit department is used also in the other areas defined in the audit charter.

4.6.2. Enterprise Risk Management not yet operational

Observation

The purpose of the internal audit department as defined in the audit charter is in line with international standards which is to provide assurance on the design, operation and monitoring of the governance, risk management and control processes. However, despite the fact that TelEm has organized an initial risk assessment workshop, enterprise risk management is not yet embedded in the organization. This implies that internal audit cannot yet fully function as a third line of defense. Various risks might be facing the company that prevent TelEm from achieving its (strategic) objectives.

Risk

An ineffective risk management framework imposes the risk that actions are not taken to mitigate the risks related to the achievement of the company's objectives.

Proposed solution

The initiative to implement enterprise risk management within TelEm needs to get a follow up to become effective. The internal audit department may provide an advisory role in this matter.

4.6.3. No direct interaction between the internal audit department and the Supervisory Board

Observation

According to the audit charter the head of the internal audit department reports to the CEO but also has direct access to the chairman of the audit committee. Currently there is hardly any interaction between the head of the internal audit department and the audit committee. The updated audit charter (2019) has not yet been approved by the audit committee/ Supervisory Board.

Risk

Lack of direct communication with the audit committee within the Supervisory Board may impair the independence of the internal audit department. Management may e.g. limit the scope of activities of the internal audit department.

Proposed solution

A direct communication line between the head of the internal audit department and the audit committee should be established, in line with the quality standards if the IIA. The latest version of the audit charter should be reviewed and approved by the audit committee. The annual audit plan of the internal audit department should also be subject to review and approval by the audit committee.

5. Closing

With this report we hope to have provided you with the requested insight into the effectiveness of internal control measures at strategic level. In case you may require additional guidance regarding the content of this report, please don't hesitate to contact us.

The Supervisory Board is responsible for dissemination of the report that is to be limited to the parties concerned. Our report should not be used for any other purpose and is only intended for you as our client. The report (or parts of it) may not be made available to third parties without our express written permission in advance.

R.N. Sandriman
Director