



Western Economic
Diversification Canada

Diversification de l'économie
de l'Ouest Canada

Audit of Accounts Receivable

WESTERN ECONOMIC DIVERSIFICATION CANADA

Audit and Evaluation Branch

October 2009

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1.0 Executive Summary

- 1.1 The audit of Accounts Receivable was identified in Western Economic Diversification Canada's (WD) approved 2009-12 Risk Based Audit Plan. Although most WD receivables were set up prior to 1995, findings from this audit were anticipated to be of value in managing future repayable or conditionally repayable contribution agreements.
- 1.2 The objective of the audit was to provide assurance that WD was in compliance with both Treasury Board and departmental policies, appropriately accounting for and managing receivables from contributions, including advances, allowances for bad debts, recoveries, and interest charges. The audit examined the monitoring framework for contribution agreements in place to ensure compliance with terms and conditions related to accounts receivable. In addition, the audit reviewed the appropriate use of repayable, conditionally repayable, or non-repayable contribution agreements.
- 1.3 The audit examined a wide range of agreements of all types in all four operational regions (BC, AB, SK and MB). Files and relevant internal and Treasury Board documents were reviewed, and interviews conducted with key personnel in the regions and at headquarters. The audit covered accounts receivable that were still outstanding during the period of April 1, 2007 to March 31, 2009. As most of WD's receivables were set up prior to 1995, most of the receivables that could have been collected have been by now. The audit focused on general accounts receivable and collections processes currently in place at WD, while recognizing the exceptional nature of the files that remained in place during the audit period and were included in the audit sample.

Findings and Conclusions

- 1.4 The audit found that from 2007 onwards, WD has put an increased effort into cleaning up its remaining receivables. WD is now taking steps to write off uncollectable receivables resulting from bankruptcy, receivership, becoming statute barred, or cessation of business.
- 1.5 The auditors commend WD for its renewed attention to clean up its old accounts receivable. However, that level of attention and focus on accounts receivable should be ongoing and sustained. A sustained focus on accounts receivable increases the likelihood of collection. Accounts that are deemed uncollectible should be written off in a timely basis.
- 1.6 The auditors found two different circumstances in which WD's financial system rounded its interest calculations and ended up with a modestly inaccurate interest charge. None of the cases sampled were material on an individual basis. However, this may be a more significant concern if WD sees an increase in repayable or conditionally repayable contributions in the future.

- 1.7 The auditors noted a lack of documentary evidence on file related to past collection activities. Whenever any action is taken on accounts receivable files, that action should be documented on file.
- 1.8 The audit noted a lack of documentation of the process and procedures followed in administering accounts receivable in the regions. These processes should be documented as part of succession planning and in anticipation of WD generating more accounts receivables in the future.

Statement of Assurance

- 1.9 In is the professional judgement of the Chief Audit Executive that sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the conclusions provided and contained in this report on the effectiveness of management controls for grants and contribution accounts receivable.
- 1.10 The assurance is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria that were agreed upon with management. The assurance is applicable to the policies and processes examined. The evidence was gathered in accordance with Treasury Board policy, directives, and standards on internal audit for the Government of Canada. The evidence has been gathered to be sufficient to provide senior management with the proof of the conclusions derived from the audit.

2.0 Introduction

Background

- 2.1 Western Economic Diversification Canada (WD) provided direct funding, often repayable, to for-profit organizations from 1987 until 1995. The funding was in the form of either repayable, non repayable or conditionally repayable contributions. In 1995, WD decided to move away from direct funding to for-profit organizations. In doing so, WD generated very few new accounts receivables after 1995. Recent economic stimulus programs introduced in the 2009 federal budget will generate more repayable agreements and new accounts receivables.
- 2.2 A recent internal audit of the Western Diversification Program identified the need for adequate control over all areas of grants and contribution receivables. For the above reasons, it is timely for Internal Audit to assess the existing management controls and processes for accounts receivable.
- 2.3 The audit found that the bulk of repayable contribution agreements were repaid in compliance with contribution agreements. This audit included examination of receivables that remain on the books. Although WD's current net receivables are small, and mainly date back to the 1990's, the amount and number of receivables should increase in the future. There exists an opportunity for WD to design its future accounts receivable and collection processes based on lessons learned from prior practices.

Audit Objectives

- 2.4 The objective of the audit was to ensure that WD was in compliance with both Treasury Board and departmental policies in accounting for and managing receivables from contributions, including advances, allowances for bad debts, write offs, recoveries, and interest charges. The audit assessed the adequacy of the monitoring framework with respect to contribution agreement terms and conditions to ensure that receivables are established in a timely manner.

Key Risks

- 2.5 Management establishes controls to mitigate risks. This audit is intended to provide assurance on the existence and effectiveness of management's controls to mitigate the following risks:
 - WD's contribution agreements are inadequately monitored to ensure that receivables are established where repayment is triggered;
 - Receivables are not recorded in a timely fashion and recipients are not notified of amounts owing;

- Recoveries are not monitored on a regular basis;
- Non-compliant recipients are not regularly followed up, and steps taken are not documented in client files;
- Variances between the allowance for doubtful accounts and actual bad debt write offs are not explained;
- Treasury Board and departmental policies are not being followed;
- Accounts receivable are misstated;
- Internal control practices including segregation of duties are inadequate;
- Systems in place are inadequate to support accounts receivable;
- Set offs are not being used where available; and
- Proper procedures for waiver of interest are not being followed.

Scope and Methodology

- 2.6 Given that most of WD's receivables were set up prior to 1995, most of the receivables that could have been collected have been by now. The audit focused on general accounts receivable and collection processes currently in place at WD, while recognizing the exceptional nature of the files that remained in place during the audit period. The audit is not designed to form overall conclusions on the management of accounts receivable over time, but just to focus on some issues identified from the sample that the auditors reviewed and the evidence they gathered.
- 2.7 The audit covered the period from April 1, 2007 to March 31, 2009, and included review of projects from the date of the contribution agreements forward in order to place the project in context and provide a complete picture. The audit examined compliance with both Treasury Board and departmental policies. The audit included review and analysis of relevant policy documents, interviews with key personnel at WD, and testing of transactions. The auditors reviewed a number of key documents including the following Treasury Board documents: The Transfer Payment Policy; Policy on Receivables Management; Financial Systems and Controls; Allowances for Valuation of Assets and Liabilities; Interest and Administrative Charges Regulations; Security for Debts Due Her Majesty Regulations; and the Policy on Active Monitoring. In addition internal WD documents were reviewed including the Debt Write Off Directive, the Interest Charging Directive, and Default and Debt Write off Procedures. All regional operational offices (BC, AB, SK and MB) were included in the scope of the audit as was Corporate Finance. The audit examined frameworks, controls, governance processes, and information generated.

Acknowledgements

- 2.8 The auditors would like to thank WD staff for the timely cooperation and assistance provided to the audit team throughout this engagement.

3.0 Findings and Recommendations

3.1 Accounting for Receivables

Criteria: WD is appropriately accounting for accounts receivable, including advances, allowances, recoveries, bad debt write offs, and interest charges. WD waives interest only where appropriate and in compliance with policy.

- 3.1.1 The auditors found that debt write offs were identified in the regions, submitted to Corporate Finance for review, and presented to the debt write off committee for approval by the Deputy Minister. WD's detailed debt write off procedures were in accordance with Treasury Board policy. In January 2009, Corporate Finance issued a Debt Write Off Directive. This directive included a checklist to be completed and placed in the project file when a write off is being contemplated, which the auditors felt was a good practice. The audit noted that one region included an assessment of what went wrong as a means of incorporating lessons learned. The auditors felt that this assessment had value that should be used in other regions. The process of writing off uncollectable receivables was found to be lengthy and took time. The Treasury Board Policy on Receivables Management and the Financial Information Strategy require that action be taken on a timely basis with respect to write offs. Once it has been determined that all possible collection action has been taken, or the recipient has gone bankrupt, then WD should take steps to write off the receivable in a timely fashion to minimize the overstatement of accounts receivable.
- 3.1.2 In accordance with WD's Debt Write Off Directive, interest is required to be charged on receivables until either the recipient is bankrupt, the agreement is revised to reflect changes, or the debt is otherwise discharged. Deputy Minister's approval is required to write off interest; however no approval is required to stop charging interest. The audit found that in one region, interest was not charged where it was felt that it would be uncollectable and would only serve to increase the amount that would be eventually written off. This practice is contrary to the directive.
- 3.1.3 The auditors found two specific circumstances in which the financial system incorrectly calculated interest. The audit noted that WD's financial system rounded fractional interest rates either up or down to the nearest whole number. Also, the financial system when calculating interest for a partial month, rounds the calculation. None of the cases sampled were material on an individual basis. However, this may be a more significant concern if WD sees an increase in repayable or conditionally repayable contributions in the future. Three of the four regions used the financial system to perform the calculation of interest. One region used a spreadsheet outside of the system to determine the amount of interest, and then inputted that amount into the system. The auditors found that the financial system permits officers to override and manually input a number of fields

thereby allowing an officer to adjust amounts as required. Adequate systems controls are needed to ensure that overrides are verified and approved.

Recommendation # 1: WD should modify its financial system to ensure it is calculating interest correctly.

Recommendation # 2: WD should modify its financial system to restrict the ability to override the fields that calculate interest on outstanding accounts.

3.1.4 Treasury Board Policy on Receivables Management requires that departments recognize receivables promptly and that they sustain efficient and effective collection practices and systems. The audit found a number of deviations from Treasury Board policy in the administration of receivables. The deviations included:

- an inappropriately approved compromise settlement with inadequate documentation;
- failure to take action on non compliant accounts;
- a case where a set off was put in place and subsequently removed for several years to allow the recipient to receive funds from another government department to pay other creditors (the Treasury Board Policy in place at that time stated that “it is government policy to maximize recoveries through set-off against other forms of government payments owing to a debtor”); and
- amendments made outside of those criteria indicated in the Departmental Delegation of Signing Authority to agreements to allow non complaint recipients to meet the terms and conditions of agreements.

3.1.5 The auditors acknowledge that these isolated issues found have to be viewed in the context of the age and nature of the files sampled. Although the audit sample is not necessarily representative of all files since 1995, the issues found in the audit sample do provide some opportunity for WD to improve its future monitoring processes.

3.1.6 During the audit, issues were found with both the financial system and reporting system. A random reconciliation conducted on one file, revealed that funds provided to the recipient as indicated in the financial system, did not match up with the amount of funds provided as indicated based on claims in the file. In conducting the audit, the auditors produced several reports using the accounts receivable function in the WD reporting system. Difficulty was found in reconciling these “canned” reports to official financial statement figures. In questioning financial officers, it was advised that these reports were not reliable for purposes of the audit and the financial system should be referred to rather than the reporting system. Work is currently underway to update the reporting system in order to reduce the number of reports and ensure accuracy. Corporate Finance needs to review the updated accounts receivable reports to ensure the reliability of those reports and ensure that the systems support is in place to accurately handle receivable management.

3.2 Monitoring of Agreements

Criteria: WD adequately monitors contribution agreements for compliance. WD establishes accounts receivable in a timely fashion when triggered by the terms and conditions of the contribution agreements.

- 3.2.1 The Treasury Board Policy on Receivables Management requires that departments vigorously pursue the collection of receivables. In 42% of the files reviewed, the auditors found little or no documented evidence of communication or follow up with recipients. Numerous files became statute barred as a result of a lack of communication with the debtor. Files that were in default of contribution agreements went unnoticed. One recipient repeatedly attempted to obtain written confirmation from WD on the balance owing, and was unable to receive a response. As a result, the recipient estimated the balance owing and remitted that amount to WD. The amount remitted was less than the actual balance owing. The difference was subsequently written off. In recent years, steps have been taken in all regions to address the old outstanding receivables and systematically write off those determined to be uncollectable. Active monitoring of files in the future is needed to increase the likelihood of collectability and to identify issues at an early stage when meaningful action can be taken.
- 3.2.2 The auditors acknowledge that these isolated issues found have to be viewed in the context of the age and nature of the files sampled. The audit sample did not include the large volume of accounts receivable files that had been successfully collected and closed since 1995 and prior to the audit period. Although the audit sample is not necessarily representative of all files, the issues found in the audit sample do provide some opportunity for WD to improve its future monitoring processes.

Recommendation # 3: WD should ensure active monitoring of files for compliance with the terms and conditions of all agreements to ensure that all accounts receivable are set up and collected in a timely manner.

- 3.2.3 In accordance with the Policy on Receivables Management, departments are to share information and resources where permitted, and to maximize recoveries through set-offs against other government payments. When a file is determined to be uncollectable, WD pursues set offs with Canada Revenue Agency, thereby allowing WD access to funds that are about to be paid to the debtor. One case was found where a set off was entered into with Natural Resources Canada. Opportunities to seek set off with other government departments in settling debts are not explored as a normal course of action.
- 3.2.4 Although one senior official referenced a departmental policy framework from the past, the department does not have a current set of policies and/or procedures in place. For the most part, the process and steps followed have not been formally documented. As a

result, it would be difficult for another person to pick up if required. As a means of adequate succession planning, WD should document its processes. In addition, although an allowance for doubtful accounts was established for receivables in all regions, there was little in the way of documentation on factors considered in calculating the allowance. The auditors felt that documentation of the steps involved in determining accounts likely to be uncollectable would be valuable information for future employees and to ensure that all relevant factors are considered in establishing the allowance. In addition, an analysis of variances between the allowance for doubtful accounts and the amounts actually written off would be valuable information in determining future allowances.

- 3.2.5 WD provided little in the way of specific training to officers on collections processes and procedures. Monitoring and payment officers should have a standard process to follow including obtaining credit reports, incorporation documents, and analyzing financial statements and other reports received. Training to assess the ability of recipients to repay and on the review of financial projections is needed. Consideration should be given to risk (i.e., understanding that WD expects to lose a certain amount of the funds provided), but this should be within an acceptable range. WD should provide its monitoring officers who may be called upon to collect on an agreement with adequate training on collections activities.

Recommendation #4: WD should document the process followed in managing accounts receivable and provide training on those procedures.

- 3.2.6 Little in the way of sharing, either of leading practices, or of issues identified was noted between the regions. Where problems were noted in the calculation of interest using the financial system, one region developed a spreadsheet to perform the calculation outside of the official financial system. There was no evidence of any sharing of this spreadsheet or of the issue itself with other regions and other regions indicated that they were continuing to use the official financial system, unaware that there was a problem with the calculation. Although WD established a Monitoring and Payments Committee in 2005, there was no evidence that this issue had been discussed. A system of sharing both best practices and concerns should be developed among the regions and with headquarters as required.

Recommendation #5: WD should adopt a system of sharing between the regions as a way to communicate issues, develop solutions, and identify leading practices with respect to monitoring and receivables issues.

- 3.2.7 WD should look to streamline and simplify its existing practices, particularly when the department expects to increase the numbers of repayable and conditionally repayable contribution agreements. In one region, a monitoring report was developed to document activity on a receivables file. The report was used to document and summarize activity

and steps taken on a file all in one place for easy reference. This information was found helpful in monitoring and prioritizing files so that action could be taken on those files with the highest priority given limited monitoring resources.

- 3.2.8 The audit found instances where recipient non-compliance should have resulted in withholding future payments, but these cases were not picked up through monitoring. In one case, the requirement was that an equity agreement with another organization be in place prior to WD flowing funds. When this requirement was not met, the contribution agreement was changed to allow funds to be flowed to the recipient. In the same file, a claim was received without the required progress report, but was approved for payment. This recipient subsequently went into bankruptcy. WD may have been able to do more to identify financial difficulties at an earlier stage in the process given the number of “red flags” and deviations from the contribution agreement. In another file, WD expressed concern to the recipient about distribution of profits to equity holders. WD took appropriate action and conducted a follow up audit by Audit Services Canada that found several instances of non-compliance with the contribution agreement and recommended that further funds not be released to the recipient. Contrary to the audit recommendation, WD entered into an amended agreement with the recipient allowing for further funds to be disbursed without meeting the requirements of the original contribution agreement. In the end, WD accepted a settlement of \$4,000 and wrote off just under \$2.9M from this recipient.

3.3 Type of Agreement

Criteria: The type of the contribution agreement entered into (conditionally repayable, repayable or non repayable) is appropriate for the nature of the contribution and in compliance with Treasury Board and departmental policy.

- 3.3.1 The audit found that the type of agreement entered into was appropriate and within policy. Where there was a possibility of the project generating a profit, WD used a repayable contribution agreement.
- 3.3.2 Despite the assertion of one senior executive, the auditors could not find documentary evidence of past consideration of security for contribution funds provided. Both Treasury Board’s and WD’s policy on Security on Debts Due Her Majesty indicate that departments should actively seek security whenever it is consistent with good business practices and would promote a more timely repayment of debts.

Recommendation # 6: WD should consider the option of seeking security on repayable contributions and formally document its resulting decision.

4.0 Conclusion

- 4.1 The audit found several areas for improvement in managing repayable, conditionally repayable, and non-repayable contribution agreements and their subsequent collections. Enhancing the active monitoring process, improving the reliability of systems data and reports, and documenting processes around receivables would strengthen management of receivables. Adequate training should be provided to officers who are required to manage collections activities and sharing of information and solutions between the regions and with Headquarters should be encouraged.
- 4.2 The audit examined several audit criteria determined through an assessment of key risks. The following table summarizes results of the criteria examined.

Results Summary by Audit Criteria

Assessed Audit Criteria	Results
WD is appropriately accounting for receivables including advances, allowances, recoveries, and write offs of bad debts, and that interest is being waived where appropriate.	Criteria mostly met
WD adequately monitors contribution agreements in order to establish receivables as required in a timely fashion.	Criteria mostly met
The nature of the agreement entered into (conditionally repayable, repayable or non repayable) are appropriate and within policy.	Criteria met

5.0 Audit Strategies and Approach

Planning

- 5.1 Audit planning started in July 2009 and fieldwork was completed in September 2009 in all four operating regions at WD. Pre-engagement meetings and preliminary survey were completed to facilitate identification of key risks, audit criteria, control elements and audit strategies. WD program and finance staff were consulted throughout all steps in the audit process.

Standards and Methodology

- 5.2 The Government of Canada internal auditing standards were used throughout the planning, conducting and reporting phases of the audit. The audit was evidence-based in order to ensure the audit assurance is fully supported. All available evidence has been examined and analyzed against the audit criteria in order to recap the results. Sources of evidence included: file reviews, interviews, review and analysis of policies, background literature and management practices at WD, review of previous audits or reviews by other assurance providers, regional visits, analytical reviews, and elaboration on cause and effect of conditions, and follow-up on previous internal audits.

Sampling

- 5.3 The identified key risks were considered in selecting project files for examination. As part of the audit evidence, the auditors randomly selected project files from all regions and including all types of agreements, for examination and tested the samples against the audit criteria. In total, 45 files were examined; 11 files each from British Columbia, Manitoba, and Alberta and 12 files from Saskatchewan.
- 5.4 The audit included interviews with 12 key WD employees representing all regions and Headquarters.

Audit Team

WD internal audit staff conducted this audit.

Donald MacDonald	Chief Audit Executive
Kathy Locke	Project Leader
Barry Neil	Internal Auditor