

**FOREIGN AFFAIRS AND
INTERNATIONAL TRADE**



**OFFICE OF THE
INSPECTOR GENERAL**

**AUDIT OF SOFTWOOD LUMBER
CONTRIBUTIONS**

February 2000

Audit Division (SIV)

TABLE OF CONTENTS

1.0	EXECUTIVE SUMMARY	1
2.0	INTRODUCTION	1
3.0	OBJECTIVES	3
4.0	SCOPE AND APPROACH	4
5.0	AUDIT FINDINGS	5
5.1	Contribution Payments to the Provinces	5
5.1.1	Contribution Payment Calculations	5
5.1.2	Contribution Authorities	6
5.1.3	Legal Defence Fund	8
5.1.4	Implementation and Administrative Costs	10
5.1.5	Consolidated Revenue Fund Reconciliation	13
5.2	Follow-up on the 1996 SIV audit of the SWL regime	13
5.2.1	Financial Inadequacies of IPPS	13
5.2.2	Reconciliation Procedures in EPC	14
5.2.3	Need for Incremental Financial Resources	15
5.2.4	Management of Accounts Receivables	17

1.0 EXECUTIVE SUMMARY

This audit of Softwood Lumber Contributions is part of our continuing series of audits of DFAIT's grants and contribution programs.

This audit follows our 1996 audit where significant financial control weaknesses were noted. Since 1996 SIV has worked from time to time with Export and Import Controls Bureau (EPD) in a consultive capacity to assist in improving its systems and processes.

The audit encompassed a review of the administrative and financial activities of the Administration and Finance Section of the Administration and Technology Services Division (EPC) carried out in implementing the Agreements between the Governments of British Columbia, Alberta, Ontario and Quebec respecting the transfer of revenues from softwood lumber product export permit granting fees. The audit covered financial transactions (contribution payments to the provinces and accounts receivable – softwood lumber exporters) for the periods 1996-97, 1997-98 and 1998-99.

Based on this audit, we are able to conclude that the Administration and Technology Services Division (EPC) of the Export and Import Controls Bureau (EPD) has made significant and notable progress in the financial administration of the Softwood Lumber Agreement (SLA). Through staffing action and implementation of a more rigorous financial control structure, all of the 1996 SIV audit recommendations, over which the management of EPC has direct influence, have been successfully addressed. In addition, we were able to satisfy ourselves that contribution payments to the provinces have been made in accordance with authorities and that they have been properly calculated. Cash receipts and the management of receivables are also being handled in a sound and effective manner. This is commendable given that the staff has to manipulate data entry and reporting through a system that is both cumbersome and not user friendly. The Import Permit Processing System (IPPS), has yet to be integrated with the Department's Integrated Management System (IMS).

Our recommendations are aimed primarily at enhancing a much improved situation, and through their implementation, EPC should be well positioned to carry out its financial administrative responsibilities for the SLA up to the termination date of the current agreement.

2.0 INTRODUCTION

Softwood Lumber (SWL) "contributions" are transfers of export fees by DFAIT to the four provinces (BC, Alberta, Ontario and Quebec) covered by the Softwood Lumber Agreement (SLA). DFAIT contributes to the provinces most of the export fees that it collects from Canadian firms exporting softwood lumber to the United States. The five-year Canada-US Softwood Lumber Agreement, signed in 1996, specifies the rules for collecting export fees from exporters. Later agreements, reached with the four provinces, set out the amounts of the contributions to be transferred to them. The amount transferred to each province is basically the amount DFAIT collects on exports

of lumber from that province, less the provincial share of DFAIT's cost to administer the SLA regime and the share of contributions to a legal defence fund which DFAIT administers.

SLA export fees are the largest single source of revenue collected by DFAIT. Over the first three years of the agreement, annual revenue has been approximately \$70 to \$100 million per year.

Payments to the provinces are generally made in the year following the year in which the lumber was shipped. For example, export fees on lumber that entered the US between April 1, 1996 and March 31, 1997 (Year 1 of the Agreement) were refunded to the provinces in fiscal year 1997/98. As a result, transfers are contributions to the provinces of prior year revenues, for which DFAIT has obtained special approval from Treasury Board.

Under the SLA Agreement, Canada may export a specific amount of lumber to the US – free of export fees. For the first year of the Agreement, this amount was 14.7 billion board feet (bfm). This is referred to as the “Established Base” (EB). In addition, Canada can ship up to 650 million bfm at the “Lower Fee Base” (LFB) fee. In the first year of the Agreement, this rate was \$50 USD per thousand boardfeet (mbfm). Shipments beyond this amount attract a higher export fee, the “Upper Fee Base” (UFB) fee of \$100 US per mbfm. There are additional mechanisms in the Agreement to help ensure that shipments are spread throughout the year (quarterly speed bumps). As well, the \$50 and \$100 rates are adjusted each year for inflation. Canada also earns an additional 92 million bfm of fee-free or bonus quota when the average price of softwood lumber remains above a “trigger-price” for a quarter. The “trigger-price” bonus quota is available for the four succeeding quarters after the quarter the bonus allocation is earned.

At the beginning of each quota year, the Softwood Lumber Division (EPS) of DFAIT allocates the EB and LFB quota to Canadian companies. Each company's quota is entered into the Administration and Technology Services Division's (EPC's) Import Permit Processing System (IPPS). The process for allocating this quota is very complex and has survived past legal challenges.

Each shipment of softwood lumber exported to the US originating from one of the four covered provinces requires an export permit from DFAIT. All permits are issued through IPPS. The shipment can be charged to either a company's EB quota or bonus quota, otherwise it attracts an export fee currently set at (\$52.93 US per mbfm if LFB quota is used, \$105.86 US per mbfm (UFB) if not).

Exporters use a Canadian customs broker to obtain these export permits. Most brokers are electronically linked to the IPPS system. When the broker enters the shipment information into IPPS, the system verifies if the exporter has sufficient quota available and calculates the resulting export fee, if any. If there is an export fee, it is printed at the broker's site on the permit (which serves as the invoice) and is set-up in IPPS as a receivable.

Administration of the SLA in DFAIT is carried out primarily by EPS, with significant administrative support provided by EPC in the areas of finance and computer systems. Exporters make payments directly to DFAIT - EPC. Cheques are received in the mailroom, logged and transferred daily to EPC. EPC staff identify the specific permits being paid, update the receivable records in IPPS and account for any partial payments or over payments. The cash receipts are then entered into the Department's financial system, IMS, and the funds are transferred to the Cashier's (SBRA) Office for deposit.

SIV conducted an audit of the financial controls related to SLA revenues in the fall of 1996 and found significant weaknesses. Since that time, EPC has made numerous changes to its cash receipts systems and processes.

3.0 OBJECTIVES

The objectives of the audit were:

- 1 To verify that the SLA contribution payments to the provinces are in accordance with authorities and properly calculated.**
 - 1.1 To verify that the proper authorities (Treasury Board) are in place for these payments.
 - 1.2 To verify the accuracy of the amount withheld in the legal defence fund.
 - 1.3 To verify the status of the legal defence fund. This will include determining the amount of money contained in the fund, determining how much has been paid out of the fund, establishing the basis for the fund balance and assessing if the fund is in compliance with provincial agreements.
 - 1.4 To verify the annual calculations of DFAIT's cost to administer the program.
 - 1.5 To verify the revenue figures used in the provincial refund calculation by reconciling them to the figures in the Consolidated Revenue Fund.
- 2 To follow-up on the 1996 SIV audit of the SWL regime and assess the current financial control structure.**
 - 2.1 To determine what changes have been made to address the financial inadequacies of the Import Permit Processing System and assess their impact.
 - 2.2 To review the status of daily cash reconciliation procedures in EPC. This review will establish if EPC is currently maintaining its daily reconciliation

procedures, to determine if errors are being properly identified, and assessing if client accounts are properly adjusted and kept in balance.

- 2.3 To review the number of financial staff working in EPC vis-a-vis the workload.
- 2.4 To assess how well accounts receivable were managed between 1996 and the end of the fiscal year 1998-1999. This will include an evaluation of the current receivable balance, to assess the action taken by EPC to effect collection of the receivables, and to evaluate if other requirements are needed to reduce the current balance.
- 2.5 To determine the status of the integration of SWL accounts receivables into the Department's financial system IMS.
- 2.6 To confirm the accuracy of the calculations of the invoice export fees for the SWL Program.

4.0 SCOPE AND APPROACH

The scope of this audit encompassed a review of the Administration and Finance Section of the Administration and Technology Services Division (EPC) carried out in implementing the Agreements between the Governments of British Columbia, Alberta, Ontario and Quebec respecting the transfer of portions of revenues from softwood lumber product export permit granting fees.

In addition, financial reporting information available from the Import Permit Processing System (IPPS) was obtained from the EDP Software Engineering Permit Systems Section of EPC. During our review of the "management of receivables", inquiries were made of and information obtained from the Softwood Lumber Division (EPS). Our audit covered financial transactions (contribution payments to the provinces) for the periods 1996-97, 1997-98 and 1998-99.

Our approach involved an examination of relevant processes, systems and supporting documentation together with interviews with key staff.

5.0 AUDIT FINDINGS

5.1 Contribution Payments to the Provinces

Our audit objective in this area was to verify that the SLA contribution payments to the provinces are in accordance with authorities and are properly calculated.

5.1.1 Contribution Payment Calculations

The Canada/Provincial Softwood Lumber Agreements for British Columbia, Alberta, Ontario, and Quebec call for payments to be made by September 1st following the fiscal year-end. One of the key variables affecting the amount of the payments to the Provinces is that it is based on the “fees collected”. When an exporter applies for an export permit, which attracts an export fee, the exporter is responsible to remit the fee to DFAIT. Experience has shown that in the ordinary course of business, these exporters take an average 20 days from the date of export, to receive their invoice and 26.5 days to remit their payment. DFAIT issues monthly financial reports to softwood lumber exporting companies. In the first 3 years of the Agreement, of the 1,196,778 permits issue, over 36,979 permits were canceled and a portion of these were re-issued. Export Permits are canceled due to duplication, errors, or new information becoming available. Export permits for which fees have been remitted and are subsequently canceled after the August 31 deadline lowers the amount of revenues to be remitted to the provinces. Identification and verification of these errors and omissions continue to take place long after the end of the allocation year.

Calculations to arrive at the annual contributions to the Provinces are made by the Deputy Director, Administration and Finance, Administration and Technology Services Division (EPC). Calculations are usually made in mid-August of each year for the previous fiscal year of the Agreement. Financial information to make these calculations comes from a variety of sources. The main source of information is the Import Permit Processing System (IPPS). For each year, reports titled “Summary Softwood Lumber Invoice by Origin Province” and “Detail Softwood Lumber Invoice by Origin Province” is obtained from IPPS. Information relative to disbursements made against the Legal Defence Fund and Administrative costs is obtained from the Softwood Lumber Division (EPS) and the Resource Planning and Management Secretariat (SMD) respectively. The results of our review of the Legal Defence Fund and Administrative Costs are described in later sections of this report.

As explained previously, the figures for permit fees invoiced, by province, continue to change as a result of permit adjustments, revisions, cancellations and fee remissions. Consequently, for example, payments to the provinces for Year 3 of the Agreement are netted amounts made up of the following:

Amount invoiced from Year 3
Less: Outstanding Accounts Receivable for Year 3
Plus: Adjustments for Years 2 & 3 (permit adjustments)
Less: Legal Defence Fund (max. 10%)
Less: Administrative Costs Year 3
<hr/>
= Amount Disbursed to the provinces Year 3

We verified contribution calculations made by EPC to IPPS financial data. Our tests included verification of mathematical accuracy and comparison of summary totals to financial spreadsheets prepared by EPC. In addition, we validated the amounts disbursed to the Provinces by obtaining and examining documentation in support of these payments. Based on our verification work, we have satisfied ourselves that the contribution payments to the Provinces have been made accurately and completely and are presented fairly in the records maintained by EPC.

5.1.2 Contribution Authorities

In addition to the Canada-United States Softwood Lumber Agreement, Canada's authorities governing the management of the Softwood Lumber Agreement are contained in the following documents:

- Amendment of Export Control List to add Softwood Lumber;
- The Softwood Lumber Products Export Permit Fees Regulations;
- Agreements between the Government of Canada and the Governments of British Columbia, Alberta, Ontario, and Quebec respecting the transfer of portions of revenues from softwood lumber product export permit granting fees.

In conducting our review of authorities for contribution payments to the Provinces, we examined relevant authority documents and conducted interviews with key staff in both EPC and EPS. We were able to conclude that payments have been made within the granted authorities.

The following comments and suggestions are made to assist management in the overall management of the contribution payments to the Provinces.

However, EPC has in the past sought assistance from a consultant engaged by EPS, in developing costing methodologies. The method currently being used was assessed by the aforementioned consultant to be basically sound. While we concur with the current costing methodology, management has not formally approved it. In addition, in view of the fact that administrative costs may continue well past the year 2001 (end of Agreement), there is a need to re-examine the current costing methodology to determine if any contingencies have to be made to provide for unforeseen implementation and administrative costs.

During our audit the issue of establishing a contingency fund was raised with both EPC and EPS. The purpose of the contingency fund would be to provide for the possibility of having to reimburse softwood lumber companies in the event that either they and/or Canada is successful in challenges of US Customs classification rulings. In the event that a contingency fund is established, a significant amount of work will be required to arrive at an amount that is both reasonable and supported by available historical data. In discussions with EPS, we were informed that, while knowledge about pending cases is available, information on the particular permit fees subject to the challenges is not

readily available. Apparently, the problem resides with the difficulty of matching the type of lumber exported with the permit data available in IPPS.

RECOMMENDATIONS

- 5.1.2.1 The present costing methodology utilized to determine annual Implementation and Administrative costs under the Agreement should be officially adopted as Bureau policy.**

EPD RESPONSES

- 5.1.2.1 Agreed. The methodology previously approved by the Director General will be officially and formally signed off.**

5.1.3 Legal Defence Fund

The terms and conditions for contributions to Canadian Provinces to transfer revenues from Softwood Lumber Product Export Fees provides the authority to withhold contribution monies to offset costs of defending Canada's interests in domestic and international legal challenges to the regime for controlling softwood lumber exports to the United States.

The formula for calculating the amount to be retained in the Legal Defence Fund is as follows:

“The exact amount of a contribution to a province will be based on the amount of revenues collected with respect to softwood lumber exports initiated in the province for the previous fiscal year inclusive of any adjustment for revenues collected for softwood lumber exports made for previous fiscal years less any funds required to offset DFAIT's cost of implementing and administering the softwood lumber export controls system and less 10% of net revenues annually (total revenues less any fee remissions, less DFAIT's costs of implementing and administering the softwood lumber export controls system), up to an accrued amount of \$20 million over the duration of the Agreement (April 1, 1996 to March 31, 2001) to be retained in the CRF to offset costs of defending Canada's interests in domestic and international legal challenges to the regime for controlling softwood lumber exports to the United States (legal defence fund). After termination of the Softwood Lumber Agreement (which includes the post termination “wind-down” period), a final payment to each province shall include the respective provincial share of uncommitted legal funds.”

We verified the contribution calculations with respect to the legal defence fund made by EPC to the IPPS financial data. Our tests included verification of mathematical accuracy and comparison of summary totals to financial spreadsheets prepared by EPC. The interpretation and application of the above formula by EPC in making its calculation of monies to be retained in the legal defence fund does not take into account DFAIT's costs of implementing and administering the softwood lumber export controls system. EPC uses the annual net revenues approach to calculate the 10% withheld. While the formula has not been strictly applied as written, the amounts involved (implementing and administrative costs) are not viewed as material and as such it is not felt that adjustments to the fund are required. Another good reason for not making an adjustment is that the maximum amount of monies allowed to be retained (\$20 million) has been reached. Using the method used by EPC, we were able to determine that the calculations have been made accurately and completely and are supported by the financial data in IPPS.

The current balance in the legal defence fund by province and expenditures against the fund as at March 31, 1999 is as follows:

	Quebec	Ontario	Alberta	B.C.	Total
Legal Defence Fund	\$6,731,810.41	\$2,904,065.10	\$1,849,880.59	\$9,272,622.90	\$20,858,379.00
Expenditures	<u>(277,032.30)</u>	<u>(119,510.17)</u>	<u>(76,127.62)</u>	<u>(385,708.91)</u>	<u>(858,379.00)</u>
BALANCE	<u>\$6,454,778.11</u>	<u>\$2,784,554.93</u>	<u>\$1,773,752.97</u>	<u>\$8,986,913.99</u>	<u>\$20,000,000.00</u>

In discussions with EPS, the feasibility of determining an estimate of the legal costs of pending cases was considered. It is felt that this would be a good exercise that could be used in conjunction with arriving at an amount for establishing the contingency fund. In addition, it would assist at arriving at a more accurate figure for Supplementary Estimates following termination of the Agreement in 2001.

RECOMMENDATION

5.1.3.1 In conjunction with implementing recommendation (5.1.2.2) the feasibility of determining a reasonable estimate of future legal costs, to be charged against the Legal Defence Fund, be considered.

EPD RESPONSE

5.1.3.1 Agreed.

5.1.4 Implementation and Administrative Costs

As mentioned previously, the terms and conditions of the Softwood Contribution Agreement with the provinces do not specifically define "Implementing and

Administering” costs. Subsequent to SIV’s 1996 audit of softwood lumber financial controls EPS engaged a consultant to provide financial advice and guidance. This led to the development of a costing methodology now used by EPC. Costs for overtime, salary, operating and capital costs, net of permit revenues are charged against contribution payments to the provinces.

The following table details costs for years one, two and three of the Agreement.

Cost	Year 1 \$	Year 2 \$	Year 3 \$
Overtime	192,783	48,279	112,054
Salary	268,220	1,696,725	1,677,360
Operating	1,379,886	1,205,335	1,949,646
Capital	441,850	241,478	47,209
Y2K-IMS	0	0	659,313
Total	2,282,739	3,191,817	4,445,582
Permit Revenues	2,407,014	2,685,996	2,730,006
Charged against the Provinces	0	502,821	1,715,576

The costing methodology used by EPC for the fiscal years 1996 – 1999 is as follows:

Cost	Method
Overtime	Actual overtime recorded which is identified as having been worked on SWL.
<i>Operating – Non-Salary</i>	
<ul style="list-style-type: none"> Communications 	Allocation (40%) of the costs incurred and projected to be incurred for communication lines. Many Customs Brokers that were added for the additional work in the implementation of the Softwood Lumber Agreement were for generating and issuing permits. Old Customs Brokers were also able to issue permits for Softwood Lumber. The allocation is based on the percentage of the number of permits issued for softwood versus non-softwood.
<ul style="list-style-type: none"> Printing 	Allocation (40%) of the costs incurred and projected to be incurred for printing permits. Allocation based on IPPS reports of the number of SWL vs. non-SWL permits issued. Allocation may in fact be low as most of the permit forms issued are for softwood lumber since import permits are now electronic.
<ul style="list-style-type: none"> Professional Services 	Made up of multi parts: <ol style="list-style-type: none"> Allocation (40%) of the actual cost of EPC projects related to softwood (i.e. disaster recovery plan). Actual Brokers’ commissions incurred for the SWL

Cost	Method
	permits that brokers issue. Figure based on an IPPS report of actual SWL permit commissions. 3. Temporary help costs for people working on SWL in the EPC Permit Monitoring and Finance sections.
• Hospitality	None
• Rentals	None
• Alterations	None
• Maintenance	Allocation (40%) of the costs incurred and projected to be incurred for maintenance (primarily maintenance contracts). Allocation based on IPPS reports of the number of SWL vs. non-SWL permits issued.
• Supplies	Allocation (40%) of the costs incurred and projected to be incurred for supplies in the division. Allocation based on IPPS reports of the number of SWL vs. non-SWL permits issued. Note that the figures for FY 1996-97 and 1997-98 also include printing costs for permit forms.
Operating – Salary	Allocation (40%) of the salary of 5 EPC - CS positions which are not fully funded by Softwood Lumber TB submission and an allocation of (10%) of 6 EPC – CR positions working in the Permit Monitoring Section. Allocation based on IPPS reports of the number of SWL vs. non-SWL permits issued.
Capital	1996-97 and 1997-98 actual cost toward Softwood Lumber Agreement 1998-99 and future FY – none.

Our audit in this area consisted of testing the mathematical accuracy of calculations made and a review of supporting documentation together with an overall assessment of the costing methodology applied for years one, two and three of the Agreement. **We were able to confirm neither the mathematical accuracy of calculations nor carry out a review of supporting documentation since EPC did not retain any paper documentation supporting the calculations made.** Given the materiality of the amounts involved and time involved to recreate the figures, we will refrain from commenting on the figures used in the calculations.

A matter of importance, that merits mentioning, is the issue of using “overhead costs” in the calculations. EPC management informed us that overhead costs were not deemed material and as such have not been considered in past calculations. Given that overhead costs apply to both EPC and EPS and that a departmental formula for arriving at overhead costs is available, an attempt should be made to arrive at a figure and assess its materiality against total implementing and administering cost. We have concluded that the methodology used is reasonable and, with the exception of missing supporting documentation, is fairly presented in the records of EPC.

RECOMMENDATIONS

- 5.1.4.1 **Overhead costs for Implementing and Administering the Agreement should be determined. In the event that they are confirmed to be significant, compared to other costs already being charged under the Agreement, consideration should be given to including them in future payment calculations to the provinces.**
- 5.1.4.2 **Documentation in support of costing calculations for implementing and administering costs should be retained on file.**

EPD RESPONSES

- 5.1.4.1 **This will be done in consultation with SMS. Determination of these overhead costs is the responsibility of Corporate Services. The determination should take into account the significance of the overhead amount in relation to overall program costs and they should also take into account the potential need to collect funds retroactively--should adjustments need to be made. On receipt of Corporate advice we are prepared to discuss this issue. Given the above two considerations, we question the extent to which this issue should be pursued.**
- 5.1.4.2 **Agreed. A file has been set up. Documentation in support of costing calculations was kept electronically. In view of the audit, files will be prepared and kept on paper.**

5.1.5 Consolidated Revenue Fund Reconciliation

One of the objectives of this audit was to verify the revenue figures used in the provincial refund calculation by reconciling them to the figures in the Consolidated Revenue Fund. This was accomplished by confirming that a process existed in the Finance unit of EPC. Our confirmation process revealed the following:

The Supervisor, Permit Fee Administration, carries out a reconciliation procedure, weekly, where permit fee and penalty revenue receipts posted through the IPPS are confirmed with revenue recorded in IMS. A sample of several weekly reconciliation sheets was reviewed to confirm the accuracy of the process and no errors were found. In view of the results of this test, it was deemed that no further audit work was required.

5.2 Follow-up on the 1996 SIV audit of the SWL regime

An objective of this audit is to assess the current financial control structure. What follows is our assessment of the current financial control structure established to address the recommendations contained in our 1996 audit.

5.2.1 Financial Inadequacies of IPPS

The 1996 SIV audit of the softwood lumber regime reported on a number of financial inadequacies of IPPS. The solution for dealing with the inadequacies was to convert IPPS cash receipts and accounts receivable functions to FINEX, which was subsequently replaced by the new Integrated Management System (IMS). This was originally planned for April 01, 1998. Conversion to IMS was rescheduled from 1998 to April 01, 1999 in line with total departmental readiness. This revised schedule was also not met. In discussions with the Integrated Financial and Materiel Management System Section (SBRI), we were informed that the implementation of the IPPS- IMS interface is now a SBRI project priority. A review of the IMS two-year work plan revealed that the introduction of full accounts receivable functionality has a scheduled completion date of April 30, 2000. In a memorandum dated October 14, 1999, the Director General, Exports and Import Controls Bureau (EPD) requested that the Director General, Resource Planning and Management Bureau (SMD) confirm an implementation date of April 01, 2000. At the close of the audit fieldwork, a confirmation of the implementation date had not yet been received by EPD.

In the interim (post 1996 SIV audit), the IPPS financial module has been upgraded and financial statements are now distributed to softwood lumber companies monthly. In addition, softwood lumber accounts receivable data is now entered (as part of the daily cash receipts reconciliation process) into the Department's general ledger accounts (revenue) for the years 1996-97, 1997-98 and 1998-99.

Our current assessment of the overall financial control structure, remembering that IPPS was not designed to be an accounting system, is that financial recording of cash receipts and receivables is carried out accurately, completely and in a timely manner. The staff of both EPC and EPS has and continues to work diligently and conscientiously in ensuring that the records for softwood lumber financial transactions are properly reflected in the accounts.

5.2.2 Reconciliation Procedures in EPC

The purpose of our review of reconciliation procedures was to determine if EPC is currently maintaining its daily reconciliation procedures, to determine if errors are being properly identified and to assess if client accounts are properly adjusted and kept in balance. The following describes our findings.

a) Daily reconciliation:

Our review of a random sample of transactions enabled us to satisfy ourselves that a daily reconciliation process is in place. Deposits are entered into IPPS by EPC, revenue figures are entered into IMS and a reconciliation process is in place. Validation of the process by management ensures adequate control of the process.

b) Action on overpaid/underpaid accounts:

We determined that action is taken immediately by EPC once an over or underpayment is identified. Companies are kept apprised of the balance in their accounts and all accounts are reconciled on a monthly basis. The staff in EPC work overtime once a month to ensure all invoices are reconciled against amounts received and any over or underpayments are taken care of at that time.

c) Division of duties:

There are currently three Permit Fee Clerks on staff in EPC. Division of duties is well defined. One Clerk is responsible for the entry of all cheques into the system (IPPS). One Permit Clerk is responsible for following up on queries, payments and accounts in arrears for all files except softwood lumber. The Finance Officer in EPC reconciles MasterCard and Visa entries on a monthly basis. Entries are immediately processed on the credit card machine and directly into IPPS. These transactions are added to the daily reconciliation calculations. The workload appears to be evenly divided.

Based on our review of this area, where we considered the appropriateness and reliability of the accounts receivable process, we have concluded it to be sound and, consequently, there are no recommendations to be made.

5.2.3 Need for Incremental Financial Resources

The 1996 SIV audit of softwood lumber included recommendations aimed at addressing the need for incremental resources in EPC¹ to deal with the workload and to effect proper division of duties. Our audit objective for this audit was to assess the current resource situation vis-à-vis the workload.

Since the 1996 audit, management of EPC has instituted a number of organizational changes that have addressed the issues raised in the 1996 audit in a positive way .

The Administration and Finance Section of EPC is now headed by a Deputy Director, who has established a Unit of five FTE's dedicated to the financial administration of softwood lumber revenues. The Unit includes an Export/Import Financial Manager and an Export/Import Finance Officer, who supervises three Finance Clerks.

Senior Management of EPC requested that the audit provide them with feedback on the direction they have taken to address workload issues as well as to comment on the adequacy of the present level of resourcing of the Unit that handles softwood lumber cash receipts.

¹ Since our scope in this area was restricted to EPC, we are not commenting on EPS resources.

One of the problems that we encountered in attempting to respond to management's request is that EPC does not, as a matter of routine, gather workload statistics. This is understandable given that IPPS is not a user-friendly system in terms of providing output reports. With the assistance of EPC, we were able to extract a data file from IPPS that contains information on cash receipts entered into the system for the period April 1, 1998 to March 31, 1999.

We were able to carry out an analysis of the database to determine volume statistics for cash receipts.

Penalty Fee Receipts for the period April 1/98 to March 31/99:

The fields in the database were as follows:

- Date Received
- Company Name
- Company Code
- Invoice Date
- Permit Number
- US Entry Date
- Cheque Number
- Invoice Amount

From our analysis of the database, we were able to extract the following cash receipt statistics:

ACTIVITY DESCRIPTION	VOLUME
Total # of permits paid during the period	16,662
Total # of cheques processed	3,564
Average # of cheques received per deposit day	15
Average # of permits paid per deposit day	72.13
Actual deposit days in the year	231
Total \$ amount of invoices paid during the period	\$82,548,444
Average \$ amount of deposit per day	\$357,352
Average \$ amount of permit paid per cheque received	\$4,954

While the above does provide the workload for cash receipts with reasonable accuracy, the reader must carefully interpret this data. Firstly, the number of cheques received on a given day cannot be predicted. Secondly, entering payments into IPPS is a multi-step process that is very time consuming and represents only the end part of the cash receipts reconciliation process. Thirdly, the resources dedicated to depositing cash receipts (non-supervisory) for softwood lumber are estimated to be 40% of the workload for the three Finance Clerks [3 x 40% = 1.2 FTE's].

Based on our observation of the cash receipt reconciliation and IPPS posting process, we are of the view that the SWL Unit (in EPC) is adequately resourced for the tasks at

hand at the present time. However, EPC management will have to give further consideration to the resource requirements prior to the accounts receivable function being integrated to IMS. An example of an important factor to consider is the number of steps (screens in IMS) that have to be utilized to post the payment of a permit and its impact on the workload in the future versus now (using IPPS).

RECOMMENDATION

5.2.3.1 Workload statistics need to be gleaned and analyzed on a regular basis if management is to resolve the issue of determining the optimal level of resources needed to administer and manage the SWL Agreement.

EPD RESPONSE

5.2.3.1 Agreed. Due to our ongoing assessment of workload and staffing, we have increased staff and will continue to monitor staffing levels on a periodic basis.

5.2.4 Management of Accounts Receivables

The purpose of our review in this area was to assess how well accounts receivables were managed between 1996 and the end of the fiscal year 1998-99. This included: an evaluation of the current receivable balance; assessing the action taken by EPC to effect collection of the receivables; and, evaluating if other requirements are needed to reduce the current balance.

Based on our review of the management of accounts receivable function, we are able to conclude the following:

- a) Responsibilities for the management of accounts receivable are split between EPC and EPS. EPC sends out monthly financial statements to softwood lumber companies indicating amounts owing and in arrears. EPS, on the other hand, is responsible for following up with companies whose accounts are in arrears. There are three softwood lumber administrators presently working on the follow-up process who report to the Supervisor of the Administrative Unit in EPS.
- b) EPS sends out letters to companies indicating amounts in arrears and requesting settlement. These letters are followed up again in 30, 60 and 90-day intervals. Once an account in arrears exceeds 90 days, a 7-day notice is sent to the company. If settlement is not reached, a 24 hour notice is sent with a warning that the company will be suspended (company can no longer apply for an export permit), if a settlement is not reached within that timeframe. Experience has shown that companies rarely go under suspension. Those that do have either gone out of business, are exporting illegally without obtaining permits or have

discontinued exporting softwood lumber. If payment is received at any time the company's suspension is lifted through the IPPS immediately.

c) Our review of a random sample of outstanding accounts revealed no major concerns. It is felt, however, that a summary of our assessment of the management of the receivable process warrants disclosure. Briefly, our assessment is as follows:

- The rationale for having EPS administer the management of receivables was explained and it appears reasonable. Briefly, softwood lumber companies apply for permits after exporting to the US. At the end of March each year, softwood lumber companies reconcile their shipment records with those of the Customs Brokers (permit adjustments, revisions and cancellations). There are numerous mitigating circumstances that can form the basis for a company not paying a particular permit. Investigating this requires an in-depth knowledge of the softwood lumber industry. This knowledge resides in EPS and not in EPC. It is too high a risk to have a large company's ability to export suspended for one unpaid permit when it has a record of being issued thousands of permits and has history of paying on time.
- The division of duties in EPS is clearly defined. There are five administrators handling the four provinces. One administrator manages the fee reporting for all of the provinces to ensure continuity and timeliness of accounts in arrears reporting. The reports are received once a week (Monday morning) and any concerns discussed. Follow-up letters are prepared and signed by the Head of the Team. Responsibility to sign suspension letters rests with the Deputy Director, EPS.
- There are occasions where the follow-up on files could be timelier. There are, however, a number of files to look at and the system used by EPS (hybrid system that does not interface with IPPS) requires a number of checks and double-checks with cash receipt information on IPPS to ensure that collection information is current. Concerns were expressed, by EPS, with the system they are using. The system is slow making the process cumbersome. System modifications, which would allow access to current company profiles would, it is felt, greatly enhance effectiveness. EPS is now dependent on system updates that do not reflect up to the minute information.
- At the moment there is little incentive for companies to pay their accounts on time. The time frame, from which a company receives its first monthly statement on amounts in arrears, to it receiving a suspension notice, can at times, exceed four months. Although the December, 1998 Notice to Exporters and Importers stipulates the financial process for collecting amounts due, the inability of the IPPS to calculate interest on overdue

accounts is the root cause in the time gap for receiving payments. The imposition of interest charges would, in all likelihood, result in timely payments and could also alleviate some of the resource requirements necessary to follow-up on overdue accounts.

The following table depicts a comparison of aged accounts receivable balances:

Overdue Period	Balance Oct 6/99 \$	# of Invoices	Balance Sept. 17/99 \$	Increase (Decrease) \$
<30	11022698.81	1613	5042404.67	5980294.14
31 to 60	1582999.85	150	302364.08	1280635.77
61 to 90	27350.77	14	937564.46	-910313.69
>90	596352.15	143	559350.24	37001.91
Total	13229401.58	1920	6841683.45	6387718.13

While the balance as at October 6, 1999 is notable, the majority of the increase is for accounts overdue less than 30 days. In addition, it reflects significant success in the reduction of 61-90 day balance. For those accounts >90 days a large number are on a "hold" situation with few being in a suspension status.

Based on our review we are able to conclude that both EPC and EPS have made noteworthy progress in the overall management of receivables since the 1996 audit [as of July/97, the receivables outstanding over 30 days was \$42 million]. Planned system improvements together with the imposition of interest charges for overdue accounts will greatly enhance an already improved situation.