FOREIGN AFFAIRS AND
INTERNATIONAL TRADE

OFFICE OF THE
INSPECTOR GENERAL

Financial Services Audit

Management of Accounts Receivable

Final Assurance Audit Report

January 2004

Table of Contents

Executive Summary

This report presents the findings of the audit of the departmental practices associated with the Management of Accounts Receivable (A/R). The objective of the audit was to determine the extent to which A/R are managed in accordance with sound comptrollership practices and in compliance with legislative and regulatory requirements.

The Department's A/R balance as of February 28, 2002 was $24.3M. Of this amount, $10.3M is incorrectly recorded as a receivable and $12M will not likely be collected. We conclude, and SMF concurs, that $2M or 9% of the February 28, 2002 A/R balance of $24.3M is considered collectible. This indicates that the Department could have managed its receivables in the past with greater due diligence. It also suggests that it is an area that deserves greater attention by all applicable stakeholders in the future.

The IMS A/R General Ledger (GL) control accounts are not reconciled to the sub-ledger details on a regular basis. Nor are several suspense GL accounts, which have A/R and recoverable expenditure accounting implications, regularly reviewed and cleared in a timely manner. This could adversely impact the integrity of the Department's financial data.

Managers responsible for managing A/R expressed concern that IMS' reporting functionality does not meet their information needs. For example, in the case of Mission recoverables, financial staff needs to follow a labour intensive process to monitor employee account balances as they do not form part of the IMS A/R Module's configuration. There is a need to review IMS's functionality as a means of improving the efficiency of the practices used in managing A/R.

Existing departmental policies and procedures do not clearly and comprehensively articulate the role, responsibilities and authority of the key stakeholders involved in the management of the Department's A/R and recoverable expenditures. Consequently, the accountability framework is weakened and the risk of uncollectible accounts increases.

The IMS A/R Module's interest calculation feature commenced in December 2001. This is a positive initiative. Mission recoverable expenses and import/export A/R are not, however, included in the A/R Module and, as such, interest on overdue accounts is not being charged. This is not in compliance with the requirements of the Administrative Charges Regulations. There is no official departmental policy on the repayment of recoverables expenditures from employees which would outline the associated terms and conditions, including the charging of interest on overdue amounts. A/R from employees amounted to $420,000 as of

February 28, 2002. As a result of the above, the Department is in non-compliance with the Regulations and is forgoing potential interest revenue.

Revenue recognition procedures were not being properly applied to record Consular Fee Revenue (CFR) earned by the Department on the sale of passports. As of March 20, 2002, there was $22.5M in CFR earned that had not been recorded in DFAIT's accounting records. Accordingly, accounting practices need to be improved to ensure the timely recognition of the CFR earned.

The Department has established, in accordance with the 1994 Debt Write-Off Regulations, an effective Debt Write-Off Committee (DWOC) which challenges collection performance data in support of its decisions.

We are concerned with the accounting practices used in establishing receivables related to the Program for Export Market Development (PEMD). Historically, the majority of these receivables are eventually written-off, or cancelled through a credit memo, when the recipient submits a NIL Revenue Sales Report. It is our opinion that the Department is using its billing process to determine the amount of the recipient's debt when it should be known with certainty prior to issuing an invoice. The use of the billing process to this end is a cumbersome and costly administrative practice. Moreover, it then "locks" the Department into tabling debts with the DWOC for write-off approval adding further administrative cost to the process.

The March 31, 2001 allowance for doubtful debts, in an amount of $8.7M, was established in a manner that was not consistent with Generally Accepted Accounting Principles (GAAP). A realistic and reasonable determination of the net realizable value of accounts receivable will require, in all future fiscal years, a detailed examination and analysis of individual receivable balances. SMF concurs and recent efforts on its part indicate that it is addressing this issue.

The Office of the Auditor General (OAG) issued a management letter describing the results of its review of the Department's general computer and automated business processing controls. The OAG's conclusions on the controls, combined with our assurance statement on the manual controls, provide a comprehensive assessment of the adequacy of the management control framework established for the management of A/R.

In summary, SMD has taken action to validate the integrity of the A/R and recoverable expenditure data recorded in IMS. In addition, efforts are being focused on strengthening the management control framework by clarifying roles, responsibilities and authorities, promulgating procedures, introducing certain key controls and improving IMS's functionality. This will improve the efficiency and effectiveness of the departmental practices associated with the management of A/R while, at the same time, bringing them in line with principles of modern comptrollership.

Recommendation Status

A total of 30 audit recommendations are raised in the report; 17 are addressed to SMF, 9 are addressed to SMS, 2 are addressed to TCE and one is addressed to each of EPC and CFSI. Management has responded to each recommendation indicating action already taken or decisions made, as well as future action. Of the 30 recommendations, management has stated that 24 recommendations have been implemented. For the remaining recommendations, management has indicated the initiatives in progress or the intended future action.

1.0 Audit Scope, Objectives, Approach and Timing

1.1 Audit Scope

1.1.1 The audit focused on the departmental practices and controls related to the management of its A/R. More specifically, the audit assessed the management control framework established to ensure that receivables are not deleted from DFAIT's accounting records until the Department has received either full payment or has properly authorized a remission, write-off or cancellation. The Passport Office did not form part of our examination.

1.1.2 The audit scope relative to departmental revenues was limited to determining the extent to which key controls embedded in the applicable Import/Export permit business processes were operating effectively during the period of 2001/02 fiscal year. In addition, we assessed the adequacy of the controls established to ensure that Consular Fee Revenues were accurately recorded in a timely manner.

1.2 Audit Objectives

1.2.1 The overall audit objective was to determine the extent to which A/R are managed in accordance with sound comptrollership practices and comply with legislative and regulatory requirements. In particular, the audit focussed on determining whether:

- Departmental A/R management practices are supported by adequate policy and procedural direction and include the reconciliation of subsidiary ledgers and controls accounts and the regular review of associated suspense account balances;

- accrued receivables, including accrued interest on over-due accounts, are accurately recorded in the proper period; and,

- A/R are valued at net realizable value on an annual basis.

1.3 Audit Approach and Timing

1.3.1 The internal audit was conducted in accordance with the Treasury Board Policy on Internal Audit and the Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing.

1.3.2 The audit examined, at DFAIT Headquarters, the major business processes and key controls associated with the management of receivables. The examination phase of this audit was conducted during the period of October 2001 to

March 2002 and focussed on account balances and transactions recorded primarily during the period of April 1, 2001 to February 28, 2002.

1.3.3 The audit approach consisted of reviewing relevant documentation and conducting interviews with staff to develop an understanding of the management control framework associated with the receivables and recoverable expenses. Flowcharts were prepared depicting work flows, preventative and detective controls in place and monitoring activities conducted by responsible managers. A judgmental sample of A/R transactions were randomly selected for purposes of determining the extent to which selected controls were being consistently and effectively applied.

2.0 Background

2.1 Roles and Responsibilities

2.1.1 Responsibility for the management of A/R and recoverable expenses is shared amongst several organizational units of the Department. The type of receivable, and/or whether it originates at Headquarters or at a Mission, has a bearing on who has primary responsibility for managing the collection activity.

2.1.2 Roles and responsibilities are described in DFAIT's Accounting Manual. Missions are responsible for managing the A/R function as it relates to recoverable expenses. The Headquarters Financial Services (SMFH) section is responsible for:

- implementing and administering the departmental accounting policy and procedures related to the processing and reporting of revenue, accounts receivables, accrued receivables and recoverable expenses;
- ensuring that proper financial codes are in place for the reporting of revenues; accounts receivables, accrued receivables and recoverable expenses; and,
- managing the Debt Write-Off Committee process to ensure that bad debts are written-off in accordance with the 1994 Debt Write-Off Regulations and DFAIT's debt write-off policy and procedures.

2.1.3 The Manager, Assets and Liabilities Management (SMFR) has overall responsibility for coordinating the management of A/R and recoverable expenses with the following exceptions:

- Distressed Canadians A/R - responsibility of the Consular Affairs Bureau, Program Services (JPP);
- PEMD A/R - established by SMFR at the request of, and based on, information supplied by the Export Development Division (TCE). The

collection of delinquent accounts is a joint effort between SMFR and TCE; and,

- Export and Import Controls Bureau (EPC) A/R (all permits) - responsibility of EPC.

2.2 Accounts Receivable Data

2.2.1 Table I depicts significant A/R balances and amounts past due (over 121 days) as of February 28, 2002. Table II provides information on the collectibility of departmental A/R balances.

Table I

Accounts Receivable Balances By Major Account Group Amounts over 121 Days @ February 28, 2002			
Accounts Group	**Balance @ Feb. 28, 2002**	**Past Due $ > 121 Days**	**Past Due % > 121 Days**
Other Gov't Departments	$ 2,931,385	$ 197,361	7%
External Customers	$ 18,577,102	$ 12,970,295	70%
Distressed Canadians	$ 595,022	$ 444,429	75%
DFAIT Employees	$ 420,667	$ 344,140	82%
Import/Export Fees	$ 2,395,144	$ 991,830	41%
Total	$ 24,379,320	$ 14,938,055	61%

Table II

Accounts Receivable Collectibility @ February 28, 2002						
1 A/R Bal. @ Feb. 28/02	**2 Less: Loss of Monies**	**3 Less: Previous Write-Offs**	**4 Active A/R (1) - (2+3)**	**5 Dept'l Estimate Uncollectible A/R**	**6 Collectible A/R**	**7 % Collectible 6/1**
$24,379,320	$ 1,305,000	$ 9,000,000	$14,074,320	$ 12,000,000	$2,074,320	9%

Note: The $9M represents receivables related to the PEMD program that had been approved for write-off by the Department's Debt Write-Off Committee but were, notwithstanding, carried forward to IMS during the FINEX/IMS conversion and remain in the reported balance for GL 14002 and 14999.

3.0 Summary Observations and Recommendations

3.1 Background

3.1.1 The Department's A/R balance as of February 28, 2002 was $24.3M. Of this amount, $10.3M is incorrectly recorded as a receivable and $12M will not likely be collected. We conclude, and SMF concurs, that $2M or 9% of the February 28, 2002 A/R balance of $24.3M is considered collectible. This indicates that the Department could have managed its receivables in the past with greater due diligence. It also suggests that it is an area that deserves greater attention by all applicable stakeholders in the future.

3.1.2 To this end, the audit findings and recommendations are described below under captions which represent the areas that should be given priority by Management in order to improve the effectiveness of Departmental A/R management practices.

3.2 Roles and Responsibilities

3.2.1 The introduction of FIS emphasized the need to revise existing departmental policies and procedures. DFAIT's response was to develop and implement the Department's "Accounting Manual" which was to augment the already existing Department's "Financial Management Manual". In spite of the two manuals, the Department's policies and procedural guidance for the management of accounts receivable and recoverable expenditures are incomplete.

3.2.2 Existing departmental policies and procedures do not clearly and comprehensively articulate the role, responsibility and authority of the various stakeholders involved in managing the Department's receivables and recoverables. The existence of two manuals has created some uncertainty amongst users, because they are not clear which of the two manuals takes precedence from a policy/procedural perspective. In part because of the absence of strong policy and procedural guidance, the Department has a large volume of past due accounts, many of which are likely uncollectible.

Recommendations for SMS

3.2.3 SMS should examine the existing policies and procedures governing the accounting and reporting of revenues, accounts receivable and recoverable expenses with a view to:

- **identifying and addressing any gaps; and,**
- **clarifying and clearly documenting the role, responsibility and authority of key stakeholders.**

3.2.4 SMS should determine which of the official manuals are to be used for guidance in the area of Revenue, Accounts Receivable and Recoverable Expenses.

SMS Responses

3.2.3 A review of the Accounting Policy with respect to Revenue, Accounts Receivable and Recoverable expenses commenced in September 2003. As part of this process, SMSP will lead a working group comprised of all stakeholders to address and resolve all outstanding A/R issues.

3.2.4 With the introduction of FIS, SMSP developed and published a (FIS) Accounting Manual for financial and accounting staff at headquarters and missions, so they account for all transactions in line with accrual accounting policies and practices introduced by FIS. This policy is the only one to be used to <u>account</u> for revenue, A/R and recoverable expenses. As a result of the introduction of the FIS Accounting manual, some portions of the Financial Management Manuals are no longer valid as they are out of date and refer to our old financial system, processes, and forms that no longer exist.

3.3 Authorities

3.3.1 Authority to post adjusting journal entries in IMS is not formally assigned. Existing procedural guidance does not specifically address the different types of transactional decisions (i.e. credit memos, allowance determination, NSFs, etc.) that impact on accounts receivable nor who has authority to access and modify IMS A/R data. The Department is at risk of having unauthorized adjusting journal entries affecting the data integrity of the accounts receivables and recoverable expenses.

Recommendation for SMS

3.3.2 SMS should ensure that the IMS Authorization Controls clearly articulate who has authority to modify IMS A/R data, to what dollar threshold and under which specific circumstances.

SMS Response

3.3.2 The Security and Authorization (Profile Generator) project, led by SMS, reviewed the security access controls to IMS for all IMS users. In June 2003, new IMS roles defining IMS users' access to IMS functionality were implemented at Headquarters. SMS worked with DFAIT managers responsible for Accounts Receivable to develop the

roles for IMS users who require access to accounts receivable functionality. As a result of this project, only a limited number of IMS users have access to accounts receivable functionality.

3.4 IMS Business Processes - A/R Reporting

3.4.1 Not all departmental managers, with A/R responsibility, consistently use available management reports thereby increasing the risk of not collecting amounts due from debtors. Available IMS A/R aging reports are presented at the account group level. This is adequate when the Account Manager is responsible for an entire account group, however, this is not always the case, because some account groups are managed by more than one Account Manager. In these cases, the A/R aging report does not identify the A/R of the individual Account Managers. In addition, other collection performance information (i.e. debt write-off ratios, A/R turnover statistics, etc.) is not generated by IMS and, therefore, cannot be assembled for reporting purposes for use and action by Management. In summary, IMS's A/R reporting functionality with respect to aging and performance reporting does not meet the needs and requirements of its users.

Recommendation for SMS

3.4.2 SMS, in consultation with stakeholders, should solicit A/R management information requirements from managers responsible for the function with a view to determining whether the current IMS A/R module adequately addresses the defined requirements and, if not, what additional functionality is required.

SMS Response

3.4.2 As noted in 3.2.3, SMSP will lead a working group comprised of all stakeholders to address and resolve all outstanding A/R issues. This will include a review of A/R management information requirements.

Recommendation for CFSI

3.4.3 CFSI, in consultation with SMS, should develop and implement a training program on the use of IMS A/R reporting features.

CFSI Response

3.4.3 The training needs on the use of IMS A/R reporting features will be incorporated into the IMS training material that will be released when the upgrade version of IMS is released in November 2004.

Recommendation for SMF

3.4.4 SMF should produce a report by type of receivable and debtor, on a monthly basis, summarizing collection performance (e.g. average collection period, collection and write-off rates). The report should be sent to the appropriate departmental managers and the appropriate level of SMD management for review and action.

SMF Response

3.4.4 Agreed. A report has been developed which includes all information recommended in the audit. This information is being passed to client programme managers to meet their requirements and is also being reviewed and actioned at the appropriate level of Management within SMD. Generating this report is currently a labour-intensive effort, as it is largely being produced off-line. SMFH will work with SMSF to create a more efficient system solution to address this problem.

3.5 Mission Recoverable Expenditures

3.5.1 SMF consulted SMS to determine the feasibility of including Mission Recoverable Expenditures as part of the IMS A/R module in order to provide the capability of aging each debtor account balance. It was determined to be feasible, but only with a significant investment of both SMS and SMF resources. Although SMF decided to invest its resources in other operational priority areas, it recognized that an alterative solution was required. As such, it provided guidance to Missions on how to use the text and allocation fields of the IMS GL Module for purposes of monitoring, clearing and reporting on recoverable expenditures. Missions have not, however, consistently followed the instructions. As a result, the Mission recoverable GL account (14020) totalling $2.5M has over 13,000 open items as at February 28, 2002, a significant portion of which have been on the books for over eight months.

Recommendations for SMF

3.5.2 SMF should remind Missions of the requirement and importance of following stipulated procedures, vis-a-vis completion of the IMS text field, when recording recoverable expenditures in GL 14020 in order to allow for the monitoring of individual account balances.

3.5.3 SMF should request Missions to review their respective "open items" recorded in GL 14020 and report on the extent to which they are past due and collectible.

SMF Responses

3.5.2 SMFF reminded all missions of the requirements vis-a-vis completion of the IMS text when recording recoverable expenditures in GL 14020 as part of the 2002/03 year-end procedures.

3.5.3 SMFF will request missions to undertake the review as part of their confirmation of the 2003/04 asset and liability year-end balances.

Recommendation for SMS

3.5.4 SMS, in consultation with other stakeholders, should re-visit the decision not to include mission recoverable expenses in the IMS A/R module in light of the audit findings.

SMS Response

3.5.4 SMSF, in consultation with other stakeholders, will analyze this requirement and re-visit the decision if required. This review will be done as part of the IMS upgrade project to the Enterprise 4.7 version.

3.6 IMS Functionality

3.6.1 The Export and Import Controls Bureau (EPD) records individual A/R account balances in the Import Permit Processing System (IPPS) at the time of sale and these accounts balances are reduced to reflect payments received from debtors. At month-end, a journal entry is made by SMFR to record the IPPS net A/R balance in IMS and to recognize the associated revenue. This entry is reversed at the beginning of the next month to ensure that the revenue is not recognized twice. While the foregoing process ensures that revenue is properly recognized and recorded in IMS, A/R information is only entered into IMS at the summary level. As a result, it is not possible to obtain from IMS the individual customer's account receivable and determine how long it has been outstanding. The IMS feature "ZIPP" Customer Account Grouping could be used for this purpose, however, no use is currently being made of this functionality. A subsidiary ledger (customer account group) needs to be established in IMS for Import/Export fees so that individual customer account balances can be effectively managed.

Recommendation for SMS

3.6.2 SMS should, in consultation with other stakeholders, establish the ZIPP customer account group once the Export/Import Control System (EICS) accounts receivable and revenue data is integrated within IMS for aging and collection purposes.

SMS Response

3.6.2 The new EICS application, and related interface to IMS, went live in June 2003. This established the ZIPP customer account group. Therefore, individual customer account balances for Import / Export fees are now available and an ageing report is available for this account group.

3.7 Reconciliation of GL Control Accounts and Subsidiary Ledgers

3.7.1 The IMS accounts receivable general ledger (GL) control accounts are not reconciled to the sub-ledger details on a regular basis. The Audit Team was able to reconcile the Period 9 balance of GL 14000 (OGDs), 14001 (DFAIT employees), 14002 (third parties) to the respective total in the Customer Open Items report but not to the ZOGD, ZEMP, ZEXT and ZDST sub-ledgers. The variance was $236,206. At the time of the audit, we were not able to determine the reason for the variance. The Department's reconciliation procedures are not clearly assigned and documented and, as such, are not entrenched as a standard work practice within SMF. A systematic reconciliation would ensure the accuracy, completeness and reliability of the IMS A/R GL control accounts.

Recommendations for SMF

3.7.2 SMFH should define and document appropriate accounts receivable reconciliation procedures.

3.7.3 SMF should ensure that GLs 14000, 14001 and 14002 are reconciled to the ZOGD, ZEMP, ZEXT and ZDST sub-ledgers on a monthly basis. The reconciliation should be documented for SMF review and sign-off. All variances should be investigated and appropriate adjustments made to Departmental Accounts Receivable records in accordance with delegated authorities.

SMF Responses

3.7.2 Agreed. The reconciliation procedures have been completed.

3.7.3 Agreed. This is being done for the all accounts receivable sub-ledgers.

3.8 Recording of Consular Fee Revenue

3.8.1 The Passport Office is responsible for posting accounting entries into DFAIT's accounting records in order to recognize the Consular Fee Revenue (CFR) earned by the Department on the sale of passports in Canada. The Passport Office recognizes a liability to the Department when it posts the sale of passports in its accounting records; however, it does not always complete the corresponding accounting entry in IMS that recognizes the CFR earned by the Department. Accordingly, the CFR is not being recorded in IMS in accordance with the requirements of the Department's Revenue, Accounts Receivable and Recoverable Expense Policy and Procedures. Because administrative arrangements between the Department and the Passport Office have not been formally established and the lack of monitoring of Passport entries by SMFR, as of March 20, 2002, there was $22M of CFR that had not been recorded in DFAIT's accounting records. Not recognizing the CFR when earned will adversely impact the integrity of the accounts receivable information contained in the summary Trial Balance Report.

Recommendations for SMF

3.8.2 SMF should ensure that all Consular Fee Revenue is recognized and recorded in IMS monthly and at year end, in accordance with the requirements of the Department's Revenue, Accounts Receivable and Recoverable Expenses Policy and Procedures.

3.8.3 SMF should establish appropriate administrative arrangements with the Passport Office representatives in support of recognizing Consular Fee Revenue on a monthly basis.

3.8.4 SMF should assign the responsibility for monitoring and reporting on all Inter-Company transactions and month end GL account balances to a SMFR resource.

SMF Responses

3.8.2 Agreed. SMFQ is now monitoring the Consular Fee Revenue generated by the Passport Office and are posting the required accounting entries to IMS on a monthly basis.

3.8.3 Agreed. The required administrative arrangements have been established with representatives from the Passport Office.

3.8.4 Agreed, as per the response to 3.8.2.

3.9 Calculation of Interest Revenue

3.9.1 Commencing December 1, 2001, the IMS module's interest calculation feature was put into operation. Interest is automatically charged on all past due amounts for those account groups included in the A/R module. Our testing indicated that for those accounts included in the IMS A/R module, interest charges are accurately calculated in accordance with subsection 155.1 (1) of the Financial Administration Act and the applicable requirements of the Interest and Administrative Charges Regulations.

3.9.2 Mission recoverable expenses and EPC accounts receivable are not integrated within the IMS A/R module. As such, interest on overdue accounts is not being charged in accordance with the requirements of the Interest and Administrative Charges Regulations and the department is forgoing potential interest revenue. In addition, there is no official Departmental policy on the repayment of recoverable expenditures from employees which would outline the associated terms and conditions, including the charging of interest on overdue amounts.

Recommendations for SMS

3.9.3 SMS, in consultation with SMF, should develop a policy for the Department's Executive Committee's approval, articulating the requirement and basis for charging interest on expenses recoverable from employees. Once approved, appropriate mechanisms should be put in place to charge interest in accordance with the policy.

3.9.4 SMS should ensure that the EICS' functionality includes the maintenance and consolidation of accounts receivable records and information in the name of the debtor so that the Department can quickly determine and analyse a debtor's total debt for management and interest calculation purposes.

SMS Responses

3.9.3 The Department currently charges employees interest for some overdue accounts; however, the Department is allowed to garnish the employee's salary on outstanding amounts so charging interest is not always required. As part of Accounting Policy review, a detailed analysis of accounts and rules for charging interest will be determined for all types of overdue accounts and these will be communicated to departmental employees.

3.9.4 The new EICS application and related interface to IMS went live in June 2003. As a result, EPC A/R are now included in the A/R module.

Therefore, individual customer account balances for Import / Export fees are now available, an ageing report is available for these accounts and interest is now being charged on overdue accounts.

Recommendation for EPC

3.9.5 EPC, in consultation with SMF and until such time the EICS application is operational, should commence charging interest on all past due Import/Export permit fee receivables using IPPS data.

EPC Response

3.9.5 EPC has determined that interest will be calculated and charged on past-due accounts as soon as the scheduled IMS interface is up and running.

3.10 Program for Export Market Development (PEMD) Receivables

3.10.1 The Department has established a Debt Write-Off Committee (DWOC) and associated business processes that capture and challenge collection performance data. Overall, the Department has been complying with the requirements of the 1994 Debt Write-Off Regulations (i.e. Regulations). There is one exception, however, which deals with the contingent repayable contributions associated with the Program for Export Market Development (PEMD). In these instances, the Department sends an invoice for the full amount of the contribution to prompt the recipient to provide the required Revenue and Sales Report (RSR). The RSR is the basis for establishing whether or not the recipient has a debt owing to the Crown and, if so, the exact amount of the obligation. In our opinion, the Department is utilizing its billing process to determine the amount of the recipient's debt when it should be known with certainty prior to issuing an invoice. The determination of the amount of the recipients debt is a TCE program responsibility that should take place, in the majority of the cases, prior to the billing process. The billing process should not be used to determine the amount of the debt. Prior to instructing SMF to issue an invoice, TCE program managers should make every attempt to have the recipient submit the RSR.

3.10.2 The use of the billing process as the primary means of determining the amount owed to the Crown by PEMD contribution recipients is a cumbersome administrative practice. Moreover, it "locks" the department into tabling debts (following the receipt of Nil RSRs) with the DWOC for write-off approval thereby adding another costly layer of administration. In order to reduce the administration, SMF has implemented a procedure whereby the PEMD receivable is removed from the Department's financial records via a credit memo without the DWOC's prior approval. This procedure is in non-compliance with the requirements of Section 8 (2) of the 1994 Debt Write-Off Regulations.

3.10.3 Both TCE and SMF agree that a more enhanced approach to determining with certainty the existence of a debt owing to the Crown is required before it is formally recognized as a receivable in the Department's Financial Records. A more robust approach is needed because the current practice of determining whether a debt truly exists through the billing process carries high administrative costs.

Recommendations for TCE

3.10.4 TCE should undertake all reasonable measures to determine with certainty that a debt is owed to the Crown prior to instructing SMFR to issue an invoice. Measures could include, in addition to the reminder notice, issuing a default notification letter indicating: the amount owing under the Agreement, a reference to the Interest and Administrative Charges Regulations and a deadline for submitting the Revenue/Sales Report.

3.10.5 TCE should request that Industry Canada/Canada Economic Development (IC/CED) offices make reference, in their "past due-date" reminder notice issued to recipients of PEMD contributions, to the specific clause(s) of the PEMD Agreement that are in default and quantify the amount of the associated potential debt.

TCE Responses

3.10.4 Management agrees with the recommendation and informed all trade officers/PEMD coordinators in the ITC/CED offices of a revised RSR recovery process during a formal training program offered during the fall of 2002. The revised process calls for TCE to send a listing of the overdue RSRs, sorted by project officer, to the PEMD coordinators, every two (2) months, for dissemination to the appropriate trade officers in the ITC/CED offices. All officers are given two (2) weeks (or more) to follow up on the overdue RSRs with their companies and to advise the PEMD coordinators of their status. The coordinators then consolidate the responses of the trade officers and refer them to TCE (or the trade officer contacts TCE directly) for appropriate action (invoicing, initiate a repayment plan, etc.), where required. A narrative description of the revised process was issued to all ITC/CED offices in October 2002.

3.10.5 Management agrees with the recommendation and will proceed with its implementation once the new G/X computer system, which is to replace Industry Canada's CMIS system, becomes operational.

Recommendation for SMF

3.10.6 SMFH should ensure that PEMD receivables proposed to be written off (as recommended by TCE) are forwarded to the DWOC for approval prior to removing the associated debts from the Department's accounting records.

SMF Response

3.10.6 Agreed. The policy has been changed to reflect this recommendation.

3.11 Debt Write-Off regulations

3.11.1 As of February 28, 2002, approximately $344K or 82% of the $420K outstanding debts from former employees (i.e. GL 14001) have been outstanding for several years, with some accounts pre-dating 1998. Reporting doubtful receivables in the Department's financial statements will overstate the A/R. These accounts should be reviewed to determine if there is a requirement to write off the individual accounts receivable. For those employee accounts that are to be written off, Treasury Board approval must be obtained.

Recommendations for SMF

3.11.2 SMF should review the debts owing by former employees in order to determine the extent to which Section 5(1) and 6 of the debt Write-Off Regulations are applicable. In the affirmative, a submission seeking debt write-off authority should be prepared and provided to the Treasury Board.

3.11.3 SMF should conduct a review of, and adjust where necessary, all General Ledger accounts used to record receivables and recoverables to ensure that only valid amounts are recorded in these accounts.

SMF Responses

3.11.2 Agreed. The submission is underway.

3.11.3 Agreed. SMF is in the process of reviewing and updating the accounts to ensure that only valid entries remain on the books. The review process is ongoing and will continue to be so. Having said that, a complete review of all HQ employee Accounts Receivable has taken place. As of the end of June 2003, there remained

approximately $275K of long outstanding accounts. Of this figure, there is one account for $175K which preliminary investigation indicates was set up in error. The analysis continues and a final determination will be made shortly. The remainder is comprised primarily of items for which the recoverable process has not yet been completed. These items are being forwarded to CCRA for collection. In the event that CCRA does not realize a refund, the items will be referred to the Debt Write Off Committee.

3.12 Allowance for Doubtful Accounts

3.12.1 The government's Financial Information Strategy (FIS) called for Departments to establish an allowance for doubtful debts for the fiscal year ended March 31, 2001. Accordingly, the Department recorded an allowance in the amount of $8.7M. Our review of that allowance indicated it was not established in accordance with Generally Accepted Accounting Principles (GAAP). Not all departmental receivables were considered in establishing the allowance. Moreover, in the case of PEMD receivables, the allowance was established by considering the debts collectively as opposed to individually. As a result, the accounts receivable were not fairly represented in the Department's March 31, 2001 financial statements. SMFR acknowledges that the March 31, 2001 allowance was not established in accordance with GAAP.

3.12.2 In terms of procedural guidance on establishing the required allowance for doubtful debts, neither DFAIT's Accounting Manual nor TB's FIS Accounting Manual provided any specific direction. They simply referred to the need to establish an allowance. The process that SMFH intends to follow for establishing the March 31, 2002 allowance is in line with the requirements of GAAP (i.e. considering all types of individual receivables). This is essential as 61%, or $14.9M, of the receivables recorded in IMS' A/R module have been outstanding for more than 121 days.

Recommendations for SMF

3.12.3 SMF should apply Generally Accepted Accounting Principles when it establishes the allowance for doubtful debts. Specifically it should:

- **Prepare an aging analysis by type of receivable;**
- **Conduct an analysis of the various receivable attributes (type, historical collection performance, other relevant information);**
- **Solicit input from the various program areas from which receivables originate (PEMD - TCE, JPP - Distressed Canadians, EPC - Import/Export Fees, SMFF - Mission Recoverables) concerning the value of an appropriate allowance;**

- **Calculate the amount/value of the allowance based on the results of the above activities; and,**
- **Ensure that an adequate audit trail of the above process is kept on file.**

3.12.4 SMF should formally approve the allowance for bad debt methodology, review its application by SMFR and authorize the annual allowance amount.

3.12.5 SMF should work closely with SMSP in the review of the policy.

SMF Responses

3.12.3 SMF is committed to applying generally-accepted accounting principles when establishing the allowance for doubtful accounts. At year-end, over 90% of the value of outstanding 3rd party receivables belonged to the PEMD program. In conjunction with TCE, a decision was taken that any PEMD accounts outstanding for more than 120 days would be deemed to be uncollectible. All remaining accounts would be considered collectible. This process has been fully documented.

3.12.4 This will remain the responsibility of SMFH.

3.12.5 Agreed.

3.13 Account Classification

3.13.1 We determined that the outstanding receivables as at February 28, 2002 included an amount totalling $1.3M related to thefts of mission/immigration funds that occurred in previous years. SMFH was not able to confirm whether or not a charge to appropriations was made in prior years to recognize the loss of monies associated with the aforementioned thefts. SMFH is in the process of assessing the appropriateness of accounting for the losses of monies as accounts receivable. The Department may be required to adjust its financial records to properly account for the loss/theft of these monies.

Recommendation for SMF

3.13.2 SMF should determine if prior years' losses of monies have been properly accounted for in DFAIT's financial records in accordance with the requirements of the TB policy on "Losses of Money and Offences and Other Illegal Acts Against the Crown" and by referring

to the Generally Accepted Accounting Principles (GAAP) promulgated by the Canadian Institute of Chartered Accountants.

SMF Response

3.13.2 SMFH will investigate and make the required accounting entries.

3.13.3 The Receivables at Year-End Clearing Account (GL 17999 - RAYE) were not correctly cleared prior to 1999/2000 because the clearing credit entry was posted to GL 24370 (a revenue account) instead of GL 17999 - RAYE. This resulted in an overstatement of the prior years' reported assets and income by an amount approximating $1.3M.

Recommendation for SMF

3.13.4 SMF should ensure that the proper accounting treatment is given to the clearing of General Ledger account 17999 as it is no longer used to record receivables.

SMF Response

3.13.4 Proper accounting treatment was used to close G/L 17999. With a zero balance, it has now been blocked from further use.

3.14 Suspense Accounts

3.14.1 Several suspense accounts, which have A/R and recoverable expenditures accounting implications, were not being regularly reviewed and cleared in a timely manner. SMFF has recently exercised a monitoring role vis-a-vis suspense accounts. Missions have been advised to clear all asset and liability accounts, including suspense accounts, and to provide a written certification of the validity of account balances.

Recommendation for SMF

3.14.2 SMF should monitor and ensure that all suspense accounts, which could impact the reported A/R and recoverable expense GL account balances, are cleared on a timely basis.

SMF Response

3.14.2 SMFF regularly monitors these accounts.

Recommendation for SMS

3.14.3 SMS should ensure that roles and responsibilities for the review and monitoring of all suspense accounts that could impact the reported accounts receivable and recoverable expenses GL account balances are clearly assigned and documented.

SMS Response

3.14.3 Agree. SMSP will clarify roles and responsibilities in the revised policy.