Health Canada | Santé Canada

Final Audit Report

Audit of Respendable Revenues (User Fees)

May 2009

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Executive Summary

Health Canada's activities subject to cost recovery include the regulation and monitoring of health products, pesticides, veterinary drugs, air and water quality, as well as a wide range of workplace health and safety programs. Each cost recovery regime was developed to support a specific Health Canada program. Unique authorities and funding arrangements have been established for each regime, and each is supported, to varying degrees, by revenues from external charging activities. For the 2007-2008 fiscal year actual Respendable Revenues were $67.7 million.

The objectives of this audit were to provide the Deputy Minister and the Departmental Audit Committee with assurance that Health Canada has an appropriate Management Control Framework in place for Respendable Revenues, and that financial controls over Respendable Revenues are adequate and effective. The audit focused on Respendable Revenues for the period April 01, 2006 to March 31, 2008, and was conducted by the *Audit and Accountability Bureau* in accordance with the Government of Canada's *Policy on Internal Audit*.

Health Canada has designed a conceptually sound management control framework for the administration of external charges. The Chief Financial Officer Branch (CFOB), via its Revenue and Costing Section, has developed a *Policy on External Charging* that *establishes* the framework for external charging in the Department. This policy incorporates requirements set under the TBS *Policy on Service Standards* and the *User Fee Act.*

Auditors found that some responsibilities assigned to the CFOB in the policy have not been delegated or communicated to specific positions within the Branch. As a result, the Department risks not meeting the policy objectives related to the charging of external fees at the point in time when fees are amended or introduced and become subject to the User Fee Act. Only fees that have gone through the Act's procedures are subject to all the Act's provisions. The department is currently working on a strategy to amend the user fees for the Therapeutic Drug Program.

The *Policy on Service Standards for External Fees* requires that relevant Service Standards accompany User Fees, and that these standards are reported to Parliament. However auditors found that, as outlined in Health Canada's *2006-2007 Departmental Performance Report*, several performance results were not reported in alignment with defined service standards.

As a result, it is difficult to determine how the Department is performing in terms of upholding service standards. As well, once fees become subject to the *User Fee Act*, the Department is at risk of miscalculating fee reductions and may not be consistently in compliance with the *User Fee Act*.

Departmental procedures and controls for recording User Fees revenues and the related account receivable are documented and in place. However, existing receivable management

procedures do not maximize the collection of revenues. The Department has not methodically communicated with clients in a timely manner to ensure collection of account receivables.

Management agrees with the recommendations, its response indicates its commitment to take action and many of the proposed actions that will address the findings have already started to be implemented.

Introduction

Background

Health Canada has various and diverse program activities for which external charges (User Fees) for regulatory and inspection services must be collected from stakeholders.

The provisions of the *User Fees Act* establish requirements for the departmental implementation of new or amended user fees. The Act further requires departments to annually submit to Parliament a list of all user fees, irrespective of when the fees were established. The Department of Justice Canada concluded that the present inventory of fees would come under the consultation and fee-reduction scope of the Act only when they are modified, after being tabled in Parliament in a user fee proposal. Only fees that have gone through the Act's procedures are consequently subject to all the Act's provisions, such as:

- fee reductions if service standards are not met;
- performance standards in those instances where no standards have ever been put in place; and
- User fee reporting against all the information elements, including performance standards and results, costs, and revenues.

Respendable revenues are taken into consideration in determining the reference levels for funding the Department. In Health Canada all User Fees are respendable. When these Respendable revenues fall short of forecasted and authorized amounts or when these revenues are not collected, funds must be covered through other appropriations within the department.

Respendable Revenues are listed, by category, in the Main Estimates. The 2007-2008 *Report on Plans and Priorities* forecasted $69.3M in planned revenues from four departmental branches, as follows:

Branch		Planned Revenue 2007-2008 (Millions $)
Health Products and Food Branch		41.2
Healthy Environments and Consumer Safety		15.7
Pest Control Product Regulation		7.0
First Nations and Inuit Health		5.4
Total Respendable Revenues		**69.3**

Objectives

The objectives of conducting this audit were to provide the Deputy Minister and the Departmental Audit Committee with assurance that:

- Health Canada has an appropriate Management Control Framework in place for Respendable Revenues; and

- Financial controls over Respendable Revenues are adequate and effective.

These objectives are consistent with the Audit and Accountability Bureau's (AAB) responsibility to assess Health Canada's strategy and practices relating to risk management, control and governance.

Scope and Approach

The period under review for this audit was April 1, 2006 through March 31, 2008.

During the audit, the Department's management control framework for external charging and the internal controls over the financial processes related to Respendable Revenues (User Fees) were examined. Specific audit criteria are noted in ***Appendix A***.

Health Canada has many programs in place which generate respendable revenue. The audit covered activities in the functional and operational units in the National Capital Region within the Chief Financial Officer Branch (CFOB), Healthy Environment and Consumer Branch (HECSB) and Health Product and Food Branch (HPFB). The audit focused on the activities related to National Dosimetry Services in HECSB, and the Therapeutic Drug Program within HPFB.

Fee setting, costing methodology, and allocation of funds are important considerations for respendable revenues. These areas were excluded from the scope of our audit to avoid duplication with two audits carried out by the Office of the Auditor General (OAG). The OAG's November 2006 Chapter 8 report on "Allocating Funds to Regulatory Programs – Health Canada" covered allocation of funds and resources, and the May 2008 Chapter 1 report on "Management of fees in selected Departments & Agencies" covered fee setting and costing methodology.

Our approach included:

- Reviewing relevant Treasury Board Secretariat (TBS) and Health Canada (HC) policies related to User Fees, recording of revenues, account receivables and cash receipts;
- Reviewing process documentation for revenues cycle including accounts receivable and cash receipts, and interviews with staff involved in the process;

- Reviewing Internal Controls matrixes to identify key controls;
- Conducting interviews with individuals in various Directorates within the CFOB (including Public Accounts & Policy, Financial Management, Departmental Resource Management & Operational Planning, Accounting Operation & Systems) regarding the application of the management control framework for external charging and reporting of respendable revenues;
- Conducting "walk-throughs" of processes to validate the steps involved in approving and recording financial transactions; and
- Testing the key controls over operational effectiveness by using a combination of interviews, analysis and inspection of sampled transactions.

The audit was undertaken by the Audit and Accountability Bureau in accordance with the Health Canada Multi-Year Risk-Based Audit Plan, approved on April 3, 2008 and the Government of Canada's *Policy on Internal Audit*.

Findings, Recommendations and Management Responses

Management Control Framework for External Charging

Audit Criteria

An appropriate management control framework should exist to administer Respendable Revenues. Roles and responsibilities should be clearly defined; communicated; understood; and executed by Program Officers.

Managing External Charging

The CFOB, via the Revenue and Costing Section (RCS), has developed a *Policy on External Charging.* This policy establishes the framework for external charging in the Department. This policy is conceptually sound and is aligned with the *User Fee Act* and TBS *Policy on Service Standards*. Through interviews and review of documentation, auditors found that significant portions of the *Policy on External Charging* have been implemented, such as:

- Developing guidelines and procedures for external fee and costing methodologies to establish a standardized approach in the implementation of external charges.
- Providing ongoing advice and guidance to programs in support of their fee activities via CFOB RCS.
- Participating in discussions with central agencies on external charging and related costing as evidenced by RCS participation in the Interdepartmental sub working group on costing.
- Reviewing and approving annual fee-related information published in the Departmental Performance Report.

However, the auditors found that the Policy has not been fully implemented as certain key responsibilities assigned to the CFOB in appendix B of the *Policy on External Charging* have not been officially delegated and or communicated within the Branch. These consist of:

- Implementing a monitoring program to ensure that the quality of standards, costing, performance against standards, and continuing cost effectiveness of each Fee are independently reviewed periodically in order to ensure good management practices throughout the life of each fee;
- Carrying out regular reviews of User Fees (by the Departmental Performance Measurement and Evaluation Directorate (DPMED) of CFOB);
- Responding to requests for dispute resolution on existing fee issues (following unsuccessful branch attempts to resolve disputes) within 30 calendar days of receipt of the request for CFO review.

Considering that some of the activities have not been delegated and or communicated, the Department risks not meeting policy objectives related to the charging of external fees at the point in time when fees are amended or introduced and become subject to the User Fee Act. Only fees that have gone through the Act's procedures are subject to all the Act's provisions. The department is currently working on a strategy to amend the user fees for the Therapeutic Drug Program.

Recommendation No. 1

It is recommended that the Chief Financial Officer ensure that all roles and responsibilities assigned to the CFOB (as outlined in Health Canada's Policy on External Charging) are appropriately delegated and communicated within the Branch.

Management Response:

Management accepts the recommendation.

A document identifying roles and responsibilities within the Departments is under development and will be added as an appendix to Health Canada's External Charging Policy.

The following are the deliverables and expected completion dates:

- Revision to the External Charging Policy to include table of Roles and Responsibilities within CFOB. – June 2009

Performance Reporting

Audit Criteria

Service Standard established, as well as actual results achieved in line with these standards must be reported in the Minister's annual *Departmental Performance Report* (DPR) to Parliament.

Performance Results of Service Standards

TBS defines and monitors the reporting requirements for External Fees. In TBS' 2006-2007 DPR monitoring exercise, Health Canada was among the leading departments in terms of reporting on external fees. However, in reviewing the Health Canada DPR for 2006-2007, auditors found that some performance results had been compiled and reported on a calendar year basis while the DPR is meant to reflect results for a fiscal year.

Auditors also observed that several performance results were not reported in accordance with service standards established. For example, with regards to:

- "Drug Establishment Licensing Fees", it was reported that 90% of licences were issued within 300 calendar days, while the standard set is 250 days.

- "Drug Submission Evaluation Fees", the performance results were reported using an average number of days to first decision, while the service standard calls for a result that measures the percentage of first decisions issued within the number of days defined in the standard.

Performance results reported in the DPR are used to calculate fee reductions, where applicable. Under the *User Fee Act* (UFA), a fee reduction should be applied where service standards have not been met. Currently there are no User Fees subject to the UFA, however several fees will become subject to the Act as they are amended. Once fees become subject to the UFA, a fee reduction will be imposed where service standards have not been met. This will, in turn, impact revenues and funding available to the Department.

As a result, it is difficult to determine how the Department is performing in terms of upholding service standards. As well, once fees become subject to the *User Fee Act*, the Department is at risk of miscalculating fee reductions and may not be consistently in compliance with the *User Fee Act*.

Recommendation No. 2

It is recommended that the Chief Financial Officer ensures that performance results reported in the Departmental Performance Report are measured adequately and are aligned with defined service standards.

Management Response:

Management accepts the recommendation.

The Chief Financial Officer will ensure that the performance results reported in the Departmental Performance Report are measured adequately and are aligned with defined service standards.

The following are the deliverables and expected completion dates:

Performance results reported will be measured in accordance to defined service standards in the next Departmental Performance Report for fiscal year 2008-2009. – December 2009

Recommendation No. 3

It is recommended that the Chief Financial Officer ensures that results reported in the DPR are consistent with the reporting period of the DPR, or that an appropriate disclosure be included to explain the discrepancy.

Management Response:

Management accepts the recommendation.

CFOB will ensure that the results reported in the DPR are consistent with the reporting period of the DPR, or that an appropriate disclosure will be included to explain the discrepancy.

The following are the deliverables and expected completion dates:

- Departmental Performance Report for fiscal 2008-2009. –December 2009

Financial Controls

Audit Criteria

Transaction control processes should exist in all branches that generate respendable revenues**.** Transaction control processes should be in place and documented to support forecasting, monitoring and reporting of respendable revenues.

Transaction control processes

Auditors found detailed documentation describing the processes for billing and collecting respendable revenues for National Dosimetry Services and the Therapeutic Drug related programs, allowing them to conclude that the transaction control processes that generate respendable revenues are appropriately documented. The process documentation has been developed by CFOB's internal control division and is maintained and updated in a central repository.

The process documentation consists of flow charts, including narrative explanations, which describe the entire revenue cycle process, the initiation of a transaction, the billing of goods and services, processing of credit notes, recording of transactions in the financial systems (SAP), the deposit of monies, accounts receivable follow-up and the write-off of uncollectable accounts. The flow charts clearly identify all the key control activities and the organizational units responsible for their execution.

Key control activities feed into a control matrix that is used to ascertain that all key risks are mitigated by a control activity. The matrix is divided into five sub-processes: initiation and input of transactions; invoicing of services; receipt of monies; reconciliation; and managing of accounts receivable.

As depicted in the diagram, found in Appendix B of the report, the services for National Dosimetry (NDS) and Authority to sell drugs services (ATS) are initiated by their respective billing systems, which automatically feed into the SAP General Ledger that then generates the invoices. The Drug Submission & Evaluation and the Drug Establishment Licensing fees billing processes are manually initiated and input into SAP billing module for invoice generation. The receivable amounts resulting from the invoiced services of NDS, ATS, DSTS and DEL are captured in the SAP A/R sub ledger. When cash is received, the transaction is recorded in SAP.

The auditors performed a walkthrough of the documented processes to ensure that key controls were in place and tested several of the key controls identified in the process such as:

- calculating and invoicing fees completely and accurately,
    - Use of authorized Price lists for invoicing purposes
    - Appropriate authorization for Revenue initiation
    - Appropriate approval for issuance of credit notes
- recording respendable revenues in the appropriate GL accounts and updating the SAP accounts receivable sub-ledger with invoices and payments,
    - Reconciliation between billing file and SAP GL
    - Processing of clearing and suspense accounts
- managing the accounts receivable for timely collection
    - Reviewing aged receivable,
    - Follow-up with client that have amounts overdue,
- depositing and recording cash receipts,

- Safeguarding of cash receipt
- Reconciling cash receipt with amount deposited.

For the key controls tested, the auditors found no deficiencies that were significant enough to prevent them from concluding that financial controls over respendable revenues are adequate and effective. Nevertheless, auditors did identify specific areas for improvement relating to the accounts receivable collection process.

Collection of Accounts Receivable

Audit Criteria

Receivables should be recognized promptly and procedures should exist to vigorously pursue their collection and to maximize recoveries.

Collection action

Procedural requirements of TBS *Policy on Receivables Management* indicate that departments should have appropriate, timely and cost-effective collection actions that will normally be progressive.

Auditors found that the Department regularly generates statements for clients, which provide a clear accounting of their obligations. Auditors also found that attempts had been made to contact some clients. However outstanding accounts were not being followed up in a timely and progressive manner. Furthermore, there is an absence of clear directions to assist officers in prioritizing outstanding accounts for follow-up and forwarding them to collection agencies, when internal collection procedures have been exhausted.

Allowance for doubtful account and write-off

As at March 31, 2008 there was $5.3M in outstanding accounts relating to HPFB and HECSB User Fees; $2.4M of which had been outstanding for over 365 days. The CFOB has implemented a methodology to estimate a general allowance for doubtful accounts, which reduces the balance of Accounts Receivable to their estimated net realizable value in the department's financial statements. As at March 31, 2008 the allowance for doubtful accounts has been established at approximately 16% of outstanding receivables.

Health Canada has a documented Debt Write-Off Policy and Debt Write-Off Procedures. The purpose of a debt write-off is to reduce the costs of maintaining records of accounts receivable that are valueless or uncollectible, and to accurately reflect the net realizable

value of receivables. The write-off of debts is subject to stringent conditions established by the TBS' Debt Write-Off Regulations. Debts are permitted to be written off when they are deemed uncollectible, providing that every effort has been made to collect the debt, including consulting with legal services to identify any steps that may be taken to recover the amount owed (e.g. negotiating a settlement) and investigating the potential for set-off. During fiscal year 2007-08, the department wrote-off approximately $100,000 in outstanding accounts relating to User Fees. Since then the department has done additional research on the long outstanding accounts receivables related to user fees to prepare additional submissions of accounts for write-off that meet the requirements.

More proactive collection procedures would reduce the amount of accounts with long outstanding receivable balances. Revenues are only recognized as respendable once they are collected. Revenues that are not collected impact on the funding available to departmental programs. Any shortfall in funding must be covered through other appropriations within the department.

Recommendation No. 4

It is recommended that the Chief Financial Officer develop clear procedures to maximize the collection of fees charged for external services. Procedures should focus on the need to be proactive, and should include formal dunning procedures[1].

Management Response:

Management accepts the recommendation.

The CFO recognizes the need to standardize all receivables management activities in the Department. Draft policy and related procedures documents were completed in March 2008. These documents include:

- Policy on Receivables Management and Charging Interest on Overdue Accounts
- Credit Management Procedure
- Billing and Interest Procedure; and
- Collection Administration Procedure

During 2008/2009 these documents have been circulated and discussed extensively with key stakeholders. The policy and procedures fully address the audit recommendation, and are expected to be approved by December 2009.

During 2008/2009 CFOB has done an analysis of long outstanding accounts receivables to assess accounts considered to be non-collectable. During the fall 2008 debt write-off exercise $439,995 in outstanding accounts related to user fees were written off. An

[1] Dunning is the process of methodically communicating with customers to ensure the collection of accounts receivable

additional $110,016 in outstanding accounts related to user fees have been submitted for write-off as part of the February 2009 write-off exercise.

The following are the deliverables and expected completion dates:

- Policy on Receivables Management and Charging Interest on Overdue Accounts
- Credit Management Procedure
- Billing and Interest Procedure; and
- Collection Administration Procedure

  Expected completion date: -December 2009

Conclusion

Health Canada has designed a conceptually sound management control framework for the administration of external charges. The Chief Financial Officer Branch (CFOB), via its Revenue and Costing Section, has developed a *Policy on External Charging* that *establishes* the framework for external charging in the Department.

Opportunities for improvement were identified in the following areas:

- Implementation of the policy needs to be completed by delegating and or communicating responsibilities within the CFOB.
- Performance results need to be reported in the DPR, in alignment with defined service standards.

Departmental procedures and controls for recording User Fee revenues and related accounts receivable are documented and in place. Auditors found no deficiencies that were significant enough to prevent from concluding that financial controls over respendable revenues are adequate and effective.

Opportunities for improvement were identified in the following area:

- Additional receivables management procedures such as formal dunning procedures should be implemented to maximize the collection of fees charged for external services.

Management agrees with the recommendations, its response indicates its commitment to take action and many of the proposed actions that will address the findings have already started to be implemented.

Appendix A

Audit Criteria

Audit Objective:

To provide assurance that Health Canada has an appropriate management control framework for respendable revenues.

Criteria:

The mandate, policy objectives, and expected results are understood by program officers. Roles and responsibilities are clearly communicated, defined, understood and executed.

Audit Objective:

To provide assurance that the financial controls for respendable revenues are adequate and effective.

Criteria:

Documentation exists to support forecasting, monitoring and reporting of respendable revenues.

Transaction control processes are in place and documented in all four branches that generate respendable revenues

Sources:

- *Health Canada policy on External Charging*
- *TBS Policy on Receivables Management*
- *Financial Administration Act*
- *User Fees Act*
- *TBS Policy on Service Standard for External Fees*

Appendix B

Revenue process overview flowchart