National Defence Défense nationale

Chief Review Services Chef - Service d'examen

CRS CS Ex

Review of Revenue Management

May 2010

7050-20 (CRS)

Canada

Table of Contents

Acronyms and Abbreviations

ADM(Fin CS)	Assistant Deputy Minister (Finance and Corporate Services)
ADM(IE)	Assistant Deputy Minister (Infrastructure and Environment)
ADM(IM)	Assistant Deputy Minister (Information Management)
AFDA	Allowance for Doubtful Accounts
AR	Accounts Receivable
CF	Canadian Forces
CFHA	Canadian Forces Housing Agency
CRS	Chief Review Services
D Air CFG	Director Air Contracted Force Generation
DFPP	Director Financial Policy and Procedures
DG Fin Mgt	Director General Financial Management
DG Fin Ops	Director General Financial Operations
DMPAP	Director Military Pay and Accounts Processing
DND	Department of National Defence
FAM	Financial Administration Manual
FMAS	Financial Managerial Accounting System
FMT	Foreign Military Training
FY	Fiscal Year
GATES	German Army Training Establishment Shilo
L1	Level One
NATO	North Atlantic Treaty Organisation
NFTC	NATO Flying Training in Canada
OGD	Other Government Department
OPI	Office of Primary Interest
PMQ	Private Married Quarters
POL	Petroleum, Oil and Lubricant
PWGSC	Public Works and Government Services Canada
TB	Treasury Board
US	United States
UXO	Unexploded Explosive Ordnance

Results in Brief

> **Overall Assessment**
>
> While there were issues with regards to the recognition and recording of revenue-related transactions, their impact on the financial statements would not be considered significant.

In accordance with the fiscal year (FY) 2007/08 Chief Review Services (CRS) Review and Evaluation Work Plan, CRS conducted a review of the revenue management practices in the Department of National Defence (DND). The FY 2007/08 departmental financial statements reported $504 million in non-tax revenue—an amount consistent with previous years. There was also an accounts receivable (AR) balance of $252 million and an associated allowance for doubtful accounts (AFDA) of $132 million. The objective of the review was to assess the process controls related to revenue management and compliance with relevant Treasury Board (TB) and departmental policies and procedures.

While issues with regards to the recognition and recording of revenue related transactions were observed, overall, the impact on the financial statements would not be considered significant. It should be noted, though, that if not corrected and given the right circumstances, these practices could lead to year-end revenue or asset recognition issues. Observed practices included waiting to process sub-system invoices into the Financial Managerial Accounting System (FMAS) until after payment had been received, the netting of revenues and expenditures, and omitting to invoice for goods or services provided.

Since the results of the review are based on the examination of revenue management practices at only six sites, it cannot be concluded that the same practices are occurring across the Department and the Canadian Forces (CF). However, the results do raise concerns regarding current revenue recognition practices and thus warrant further follow-up.

Findings and Recommendations

Accurate and Timely Revenue Recognition. The accuracy and completeness of reported revenue amounts could be adversely impacted due to inconsistencies and omissions in the reporting of revenue transactions. Use of sub-system-generated invoices rather than those produced by FMAS make tracking between invoices and receipts difficult. In addition, the netting of revenue and expenditure transactions related to fuel exchange transactions results in an understatement of both revenues and expenditures.

It is recommended that Director General Financial Management (DG Fin Mgt) and Director General Financial Operations (DG Fin Ops) communicate with Level One (L1) Comptrollers in order to make them aware of the revenue-related issues that have been observed and to have them ensure that appropriate procedures are put in place to make certain all revenue sources are identified, processed and recorded in accordance with existing departmental revenue policy and direction.

Monitoring and Collection of Accounts Receivable. As at 31 March 2008, 64 percent ($121 million) of the non-government AR balance ($189 million) had been outstanding for more than six years and an AFDA equal to 70 percent ($132 million) of the non-government AR had been established.

It is recommended that DG Fin Mgt and DG Fin Ops, with the cooperation of L1 Comptrollers, ensure that roles and responsibilities regarding the monitoring, recording and collection of AR are clearly understood and followed, and that collection or write-off action is initiated for long outstanding AR balances.

Note: For a more detailed list of CRS recommendations and management response, please refer to Annex A—Management Action Plan.

Introduction

Background

The FY 2007/08 departmental financial statements reported $504 million in non-tax revenue (Figure 1). DND generated approximately 84 percent of its revenue through the sale of goods and services. These goods and services include the provision of rations and single quarters to military members, financial arrangements related to petroleum, oil and lubricant consumption, projects with other countries, and services, such as facilities rental, provided to other government departments (OGD). The balance consists of interest and gains on foreign exchange and gains on disposal of assets, such as real property, surplus assets and intellectual property patents.

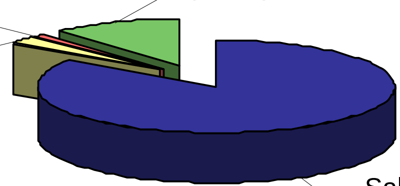

Figure 1. FY 2007/08 Total Non-tax Revenue. This pie chart presents the total DND non-tax revenue of $504 million, categorized as sales of goods and services, gains on disposal of assets, interest and foreign exchange gains and other revenue. Source: DND Performance Report for the period ending 31 March 2008. The data is summarized in Table 1.

DND Non-tax Revenue	Amounts
Gain on Disposal of Assets	$13M
Interest and Foreign Exchange Gain	$8M
Other Revenue	$58M
Sales of Goods and Services	$425M
Total	**$504M**

Table 1. Summary of FY 2007/08 Total Non-tax Revenue.

The current revenue recording process involves the selling location entering invoice information in FMAS upon the delivery of goods or service to the client. Subsequently, Director Military Pay and Accounts Processing (DMPAP) generates and sends an invoice to the client. All payments for these invoices are forwarded to DMPAP for recording and processing. Bases, however, also receive and record cash payments related to the provision of food services and accommodations.

Objectives

The objective of the review was to assess the adequacy of processes related to revenue management and compliance with relevant TB and departmental policies and procedures.

Scope

The review covered three years of revenue and AR from FY 2005/06 through 2007/08, but primarily focused on account balances and transactions recorded in FY 2007/08. Revenue related to foreign military training (FMT) at Suffield, Canadian Forces Housing Agency (CFHA) (both subject to separate audits), and refunds of prior years' expenditures were excluded (see Figures 2 and 3).

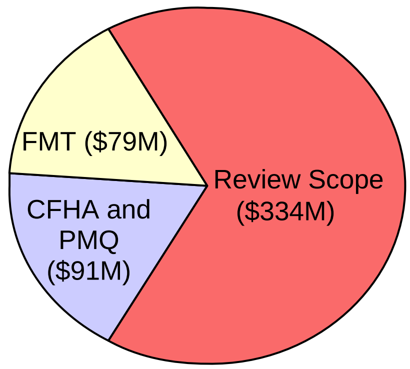

Figure 2. FY 2007/08 Total Non-tax Revenue Review Scope. This pie chart presents the review scope ($334 million) and the two areas that were excluded: FMT ($79 million) and CFHA and PMQ ($91million). The data is summarized in Table 2.

Non-tax Revenue Review Scope	Amounts
CFHA and PMQ	$91M
FMT	$79M
Review Scope	$334M

Table 2. FY 2007/08 Total Non-tax Revenue Review Scope.

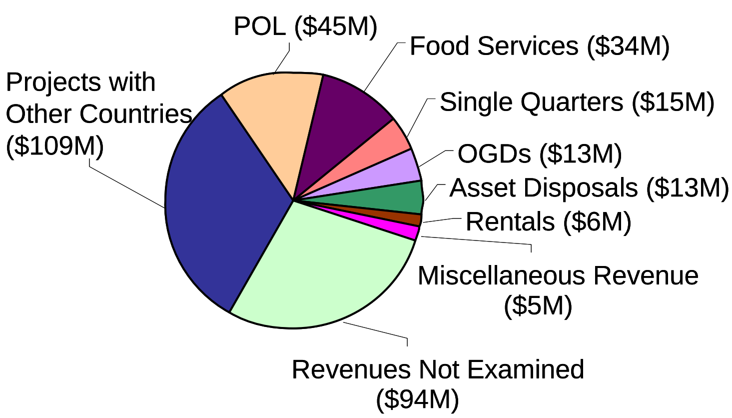

Figure 3. Breakdown of FY 2007/08 Review Scope. This chart shows what the $334 million subject to review[1] represents in terms of the overall revenue stream. The information is summarized in Table 3.

[1] "Revenues not Examined" included items such as GATES UXO settlement, pay transactions, military sales, research and development services, interest earned.

Review Scope	Amounts
Projects with Other Countries	$109M
POL	$45M
Food Services	$34M
Single Quarters	$15M
OGDs	$13M
Asset Disposals	$13M
Rentals	$6M
Miscellaneous Revenue	$5M
Revenues Not Examined	$94M
Total	**$334M**

Table 3. Breakdown of FY 2007/08 Review Scope.

Methodology

The observations and recommendations of this review are based on the results of the following activities:

- Review of policies, procedures and systems, data and document analysis, interviews with stakeholders, examinations of sub-systems, and validation of the revenue collection activities.
- Six site visits—one for each of the three environments and three at National Defence Headquarters.

Criteria

Criteria on which the assessment of the revenue management process was made are detailed at Annex B.

Findings and Recommendations

Accurate and Timely Revenue Recognition

The accuracy and completeness of reported revenue amounts could be adversely affected as a result of observed inconsistencies and omissions in regards to the recognition, processing and reporting of revenue transactions.

Revenue transactions are tracked and processed through various means. In some cases, sub-systems are used to produce invoices while in others locally generated spreadsheets are used to track and record revenue transactions and serve as the backup for FMAS-generated invoices. Where sub-systems are used, the invoices generated by the system are not always referenced in FMAS and may not be processed in FMAS until after the sub-system invoice has been paid. In such cases, revenue may not be recognized in the appropriate period and the corresponding AR would never be recognized; instead the transaction is recorded as a cash sale. Where sales transactions are tracked using spreadsheets, identified difficulties ranged from confirming the accuracy and completeness of source information to general ledger recording issues related to the netting of sales and purchase transactions. The following are examples of some of the situations observed during the review.

Food Services

Food and catering services are invoiced based on catering agreements. Subsequently, these transactions are recorded in Unitrak and FMAS as cash sales after an invoice is paid. No AR is set up in FMAS and thus it is difficult for either DMPAP or the local comptroller to easily determine the true AR at a given point in time. Depending on transaction timing, this process could result in an under-statement of reported revenues at the time financial statements are produced.

Additionally, in FY 2007/08 there was a difference of approximately $1 million between the FMAS and Unitrak revenue figures which had not been reconciled. The Director Food Services has since identified transactions types which contribute to this difference and are implementing a process to ensure the systems are reconciled on a regular basis.

It should be recognized that waiting until after payment has been received before recording revenue transaction in FMAS is not limited to food services transactions. There are indications that, at the high end, as much as 43 percent of the FY 2007/08 cash sales of $29.1 million should have been recognized and recorded as revenue with an associated AR. These sales transactions will have to be reviewed at a local level to determine whether or not there is a need to amend current revenue recognition and processing practices related to these transactions types.

Exercise Maple Flag/NATO Flying Training in Canada (NFTC)

A similar procedure to that used to invoice for food services was followed when countries were invoiced for costs related to their participation in Exercise Maple Flag. Only two of seven participating countries received invoices that were recorded properly in FMAS as sales transactions. The remaining participants received invoices from a sub-system and the revenue was recognized as a cash sale when payment was received. In this case, cash sales represented 90 percent of the total recovered value of $1.6 million. These sub-system invoices were not referenced to payments recorded in FMAS and because the transactions were only recognized upon receipt of payment, no ARs were ever set up in FMAS.

In the case of NFTC transactions which represented $99 million of the $108 million falling under the revenue category "Projects with Other Countries," 39 sample transactions with a value of $42 million were selected and tested. With the exception of three minor errors that have been discussed with D Air CFG staff, the NATO participants were billed in accordance with terms and conditions of existing memoranda of understanding.

Canada/United States (US) Fuel Exchange

The current agreement between Canada and the US regarding the supply of fuel requires that the reconciliation and settlement of the issues and receipts of fuel be performed on a semi-annual basis. The reconciled balances are then settled by netting the total issues and receipts and having the country that issued more fuel than it received invoice the other.

While the netting procedure simplifies the invoicing and payment process, the resultant FMAS entries do not always reflect the full extent of the period's transactions and the intent of the DND Financial Administration Manual (FAM) which emphasizes the importance of recognizing and recording expenditures and revenues at full value. For example Table 4 reflects the net effect of issues and receipts of naval fuel over the period of April 2007 through September 2007. In this case, Canada issued $1.2 million of fuel to the US while in turn receiving $4.3 million of fuel from the US. When the invoice was received from the US, an entry for $3.1 million in fuel expenditures was processed in FMAS rather than an entry for $1.2 million in revenue and $4.3 million in expenditures. While the payment amount may be accurate, the financial statement's revenue and expenditure amounts do not reflect the full extent of the transactions.

Time Period	Actual Revenue (A)	Recorded Revenue (B)	Recorded Receivables (C)	Actual Expenditures (D)	Recorded Expenditures (D)-(A)
April to September 2007	$1.2M	$0M	$0M	$4.3M	$3.1M

Table 4. Revenue and Expenditure Netting. April–September 2007 Canada/US fuel transactions.

In FY 2008/09, $6.4 million was recorded in FMAS as revenue carried forward from FY 2007/08. No invoice was issued to the US. Instead, the $6.4 million was netted against fuel expenditures for the October 2008 to March 2009 time period. Consequently, FMAS did not accurately reflect the full value of fuel-related revenue and expenditure transactions that took place over the two-year (2007/08 and 2008/09) period. The Chief of the Maritime Staff has since made efforts to correct recorded transactions and has issued instructions to both Maritime Forces Atlantic and Maritime Forces Pacific to ensure future transactions are recorded appropriately.

Disposal of Real Property

While the Assistant Deputy Minister (Infrastructure and Environment) (ADM(IE)) is the Office of Primary Interest (OPI) for all realty transactions,[2] the actual recording of financial transactions related to the disposal of realty assets requires the coordinated involvement of numerous departmental organizations.

In FY 2007/08, ADM(IE) Comptroller staff identified $18.7 million as proceeds from the disposal of real property. Out of this total, $14.7 million was received from the Canada Lands Company and $4 million[3] from Public Works and Government Services Canada (PWGSC) for routine disposals. Although ADM(IE) had supporting documentation for the proceeds from the disposal of real properties, not all the required transactions could be traced to FMAS.

When comparing the FY 2007/08 records maintained by ADM(IE) Comptroller staff to FMAS transactions, $4 million that had been received from PWGSC for routine disposals could not be traced to FMAS. Further comparison of previous years' documentation to recorded FMAS entries resulted in the identification of a further $1.1 million of routine disposals for the period of December 2005 to March 2007, which could not be traced to FMAS.

ADM(IE) has acknowledged the revenue recognition issue in DND and is taking the necessary action to correct the situation as it pertains to the IE Group but further investigation by Assistant Deputy Minister (Finance and Corporate Services) (ADM(Fin CS)) staff is required to determine the status of the amounts that could not be traced to FMAS.

Recovery of Circuit Charges

Canada has a cost-sharing agreement with the US regarding cross-border circuit usage. It was determined that no invoice had been issued to the US for circuit usage after 2003. It was not until 2008 that the Assistant Deputy Minister (Information Management) (ADM(IM)) staff issued a $1.8-million invoice as partial billing for the FY 2004-2008 timeframe.

---

[2] Paragraph 15, FAM Chapter 1019-2—Accounting for the Disposal of Surplus Assets and the Return of Proceeds from the Disposal of Surplus Assets.

[3] CRS received the Real Property Disposition Revolving Fund Report for FY 2007/08 from ADM(IE) which details the real properties disposed of by PWGSC. The numbers recorded in this report are subject to change due to the timing of the report.

ADM(IM) staff has been unable to identify all circuit usage attributable to the US because the National Telecommunications Management System used to track department-wide circuit services did not identify whether a circuit was being used by the US or DND. The new Global Defence Network Services system has the capability to identify users and thus will facilitate future invoicing. Between 2001 and 2003, Canada billed the US $5.1 million for circuit usage under this agreement. Based on this amount, it is possible that as much as $4 million has yet to be recovered for this period. This issue has been brought to the attention of the comptroller's office of ADM(IM) and action has been taken to improve current and future recovery procedures and to identify and recover for past usage as required.

Expenditure Reallocation Recorded as Revenue

Through an analysis of FMAS transactions, it was determined that $2.6 million of expenditure reallocations, including transactions such as separation expenses, had been recorded as revenue instead of cost recoveries or expenditure reallocations between units. As a result, reported annual revenue was overstated by this amount, with a corresponding understatement of departmental expenditures.

When one unit provides a service to another, there should be no impact on the departmental revenue accounts. The transaction should simply be treated as a transfer of expenditures between the units involved. Although departmental policies provide definitions of revenue and reallocation of expenditures, local operating procedures applied by base revenue cells do not always clearly distinguish the difference between the two transaction types.

Recommendation

It is recommended that DG Fin Mgt and DG Fin Ops communicate with L1 Comptrollers in order to make them aware of the revenue-related issues that have been observed and to have them ensure that appropriate procedures are put in place to make certain all revenue sources are properly identified, processed and recorded in accordance with existing departmental revenue policy and direction.
OPI: ADM(Fin CS)/DG Fin Mgt and DG Fin Ops

Monitoring and Collection of Accounts Receivable

As at 31 March 2008, 64 percent ($121 million) of the non-government AR balance ($189 million) had been outstanding for more than six years and an AFDA equal to 70 percent ($132 million) of the non-government AR had been established.

Allowance for Doubtful Accounts

As of 31 March 2008, the departmental AR was $252 million of which $63 million was receivable from OGDs and $189 million was receivable from other countries, private corporations, and CF members.

Age Grouping	0 to 1 Year	1 to 6 Years	> 6 Years	Total
Total ($ in millions)	$39.81	$28.46	$120.96	$189.23
Percentage	21%	15%	64%	100%

Table 5. FY 2007/08 Aged Receivables—Non-government Receivables. Aged status of the non-government ARs as at 31 March 2008.

Of the total $189 million non-government receivables balance (see Table 5), an AFDA had been set up for $132 million or 70 percent of the total AR. An AFDA is established for AR balances that have been outstanding for a period of at least 90 days and where future collection of the account is deemed unlikely.

Of the $132 million AFDA balance, $116 million was related to two accounts that had been outstanding for more than six years. Records showed that no collection activities had been taken by DND over the past three years, and it was highly unlikely that the Department would eventually collect any of the $116 million. Although DND stakeholders had initiated the approval process to write off this receivable, at the time of this review, the documentation could not be located. The write-off process was re-initiated and the $116 million was subsequently recommended for write-off by the Departmental Write-Off Committee in March 2009. Removing this amount from the outstanding non-government AR balance of $189 million leaves an outstanding balance of $73 million and a corresponding AFDA of $16 million or 22 percent of non-government AR. It should be recognized that clearing this amount does not impact the reported net AR balance; the net non-government AR would still be $57 million.

Recommendation

It is recommended that DG Fin Mgt and DG Fin Ops, with the cooperation of L1 Comptrollers, ensure that roles and responsibilities regarding the monitoring, recording, and collection of AR are clearly understood and followed, and that collection or write-off action is initiated for long outstanding AR balances.
OPI: ADM(Fin CS)/DG Fin Mgt and DG Fin Ops

Annex A—Management Action Plan

Accurate and Timely Revenue Recognition

CRS Recommendation

1. It is recommended that DG Fin Mgt and DG Fin Ops communicate with L1 Comptrollers in order to make them aware of the revenue-related issues that have been observed and to have them ensure that appropriate procedures are put in place to make certain all revenue sources are properly identified, processed and recorded in accordance with existing departmental revenue policy and direction.

Management Action

With respect to the disposal of real property and recognition of related revenue in DND's accounting system of record, Director Financial Policy and Procedures (DFPP) will review applicable policies to ensure that the financial roles and responsibilities for disposal of real property have been clearly outlined. Specifically, FAM chapters concerning the Disposal of Surplus Assets and Interdepartmental Settlements will be reviewed.

OPI: ADM(Fin CS)/DG Fin Mgt **Target Date:** FY 2010/11

In addition, DG Fin Ops will promulgate a letter to L1s to describe the issues observed in the CRS review, identify the expected accounting action, and request appropriate modification of Command Comptroller Inspection processes to prevent future recurrence. This letter will address both revenue and AR operational concerns.

OPI: ADM(Fin CS)/DG Fin Ops **Target Date:** By September 30, 2010

Monitoring and Collection of Accounts Receivable

CRS Recommendation

2. It is recommended that DG Fin Mgt and DG Fin Ops, with the cooperation of L1 Comptrollers, ensure that roles and responsibilities regarding the monitoring, recording and collection of AR are clearly understood and followed, and that collection or write-off action is initiated for long outstanding AR balances.

Management Action

It is recognized that there is a need for additional policy direction. DFPP will be developing a new FAM Chapter entitled "Credit Management" that will provide policy guidelines to identify when credit can and cannot be granted to clients of DND. An update to FAM Chapter 87 "Write-off of Debt" will also be finalized, providing criteria, timelines, and additional instructions for AR write offs.

OPI: ADM(Fin CS)/DG Fin Mgt **Target Date:** FY 2010/11

Annex A

Action Completed. Write-off action ($116 million) has been completed for a majority of long outstanding AR. Accordingly, the recommendation that collection or write-off action be initiated for long outstanding AR balances is considered satisfied. DG Fin Ops is now focussed on sustaining activity to minimize long outstanding AR balances.

Annex B—Review Criteria

Objective

1. DND Revenue management framework is in compliance with TB and DND policies.

Criteria

- Revenue management framework adheres to comprehensive, clear and concise policies.
- Appropriate procedures are in place for stakeholders to follow.

Objective

2. Appropriate systems and processes are in place to manage the complete chain of revenue management activities.

Criteria

- Systems functions and process controls are in place to record revenue and AR in FMAS accurately in the appropriate accounting period.

Objective

3. Relevant and reliable information available for reporting and monitoring.

Criteria

- Regular monitoring activities are performed to ensure revenue is recognized, AR is set up promptly and revenue is collected.