Canadian Grain Commission
Commission canadienne des grains

Audit of Producer Cars

Audit and Evaluation Services Final Report

Canadian Grain Commission

February 2018

Canada

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1. Executive summary

Producer railway cars are a method for farmers to ship their own grain outside of the commercial elevator system in railway cars loaded at designated producer railway car loading sites. The Canada Grain Act has provided for this grain transportation alternative since 1912. The Canadian Grain Commission (CGC) is designated to accept applications for producer railway cars and allocate cars according to the method set out in the Canada Grain Regulations.

Within the Industry Services division, the Producer Cars unit is responsible for processing producer railway car orders by working with the railways to authorize and allocate cars on a first-come, first-served basis. Farmers may submit applications through a third-party grain dealer known as an administrator or directly to the CGC. Once payment is received, producer car officers allocate available cars according to the request on the application. Producer car officers ensure that the allocation of cars is in the proper order and each producer has a confirmed sale and destination for the grain being loaded in the producer railway car.

The internal audit of producer cars was identified in the 2017-2018 risk-based audit plan because of the program's significance to Canadian farmers. The objectives of this audit were to provide assurance that the producer car unit implements effective and efficient controls over processing orders, invoicing and collection of fees and that car allocation is fair and accurate. The objectives also included assessing whether producer railway car processes are in compliance with legislation, policies and orders. The internal audit was conducted from May to June 2017 and included testing of data and transactions from April 1, 2016 to March 31, 2017.

Conclusion

The audit concluded that staff in the producer car unit thoroughly review applications and accurately allocate producer railway cars in a fair manner. They work with farmers and administrators to ensure payments are processed in a timely manner, and collaborate with the Canadian railways so that producer railway cars are allocated as close to the desired date as possible. One recommendation was made regarding the day-to-day processing of applications in the area of cash controls (reconciliation and review).

The CGC typically issues an annual order with information and direction related to the ordering of producer railway cars. The order in effect during the audit period could not be clearly interpreted and therefore we could not conclude on compliance with the order's requirements. A recommendation to clarify the wording of the order was made and resolved by management and the Commissioners prior to the completion of the audit. One recommendation was also made regarding producer railway cars that are destined for facilities that, for various reasons, are not licensed by the CGC.

Management has provided realistic action plans to address each of the 3 recommendations in this report.

Statement of assurance

In the professional judgment of the Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the opinion provided in this report. The opinion is based on a comparison of the conditions as they existed at the time, as described in the audit scope, against pre-established audit criteria. The opinion is applicable only to the activity examined.

The audit approach and methodology followed the International Standards for the Professional Practice of Internal Auditing as defined by the Institute of Internal Auditors and the Directive on Internal Audit, as required by the Treasury Board Secretariat's Policy on Internal Audit.

2. Introduction

Authority for audit

The mission of the internal audit function of Audit and Evaluation Services (AES) is to provide independent and objective assurance services designed to add value and improve the CGC's operations. Internal audit helps the CGC accomplish its objectives by using a systematic, disciplined approach to assess and improve the effectiveness of risk management, control and governance processes.

AES included the Audit of Producer Cars in the 2017-2018 risk-based audit plan. The Departmental Audit Committee recommended approval of the audit plan to the Chief Commissioner in May, 2017.

Background

Producer railway cars are rail cars that are ordered by and allocated directly to farmers for shipping their grain as provided for in the Canada Grain Act. The cars are loaded at railway sidings (short sections of track next to the main line where railway cars can be left for loading) or at dedicated producer railway car loading facilities instead of through grain elevators (primary elevators). This provides farmers an opportunity to market and deliver their own grain. Producer railway cars also provide an alternative to transporting grain by truck for long distances, especially when farms are located in remote growing areas. Although some producer railway cars are destined for a port location for export, the largest portion of cars go directly to food processors in Canada and the United States. In the 2016 to 2017 fiscal year, slightly less than half of producer railway cars were bound for a destination in the United States. The majority of producer cars are loaded in t Saskatchewan.

The ability of farmers to apply for a producer railway car and the responsibility of the CGC to allocate available rail cars to farmers are written in section 87 of the Canada Grain Act. Although less than 1% of grain from western Canada is transported using this method, the entitlement to a producer railway car is often seen as a right of western Canadian farmers because of the opportunities provided. The entitlement of farmers to access rail cars and move grain without the participation of elevator companies has been part of the Act since its inception in 1912.

The CGC's producer car unit is responsible for processing producer car applications by working with railways to authorize and allocate available cars. The CGC does not have any influence over the number of producer cars available nor when they will be spotted at the siding or loading facility. The producer car officers use the CGC's established rules to ensure cars are allocated fairly to farmers.

The Audit of Producer Cars was identified due to the importance of the program to farmers and the resulting high profile of the program in the industry. The recently-developed computer application that automated some application processing also created an opportunity to review the program. The audit field work took place from May to June, 2017.

Objectives

The objectives of the audit were:

1. to assess whether the processes are in place to enable efficient and effective controls over processing producer railway car orders, invoicing and collection of fees
2. to determine if producer railway cars are appropriately allocated according to established rules
3. to provide assurance that producer railway car processes are in compliance with applicable legislation, policies, and orders

Scope

The scope of the Audit of Producer Cars included all producer railway car activities associated with the 3 audit objectives during the fiscal year from April 1, 2016 to March 31, 2017. This includes the transition to the crop year beginning August 1, 2016 and the publishing of the annual Commission Order related to producer railway cars.

Current proposals related to producer railway cars, such as bulk ordering of cars and potential licensing of producer railway car loading facilities, were not specifically in scope but aspects were reviewed as they related to the audit objectives.

Approach and methodology

The audit methodology used by AES is based on guidance provided by the Institute of Internal Auditors (IIA) and the Office of the Comptroller General of Canada. The standards for internal audit are articulated in the IIA's International Professional Practices Framework and the Treasury Board Secretariat's Policy on Internal Audit.

3. Findings and recommendations

Objective 1: to assess whether the processes are in place to enable efficient and effective controls over processing producer railway car orders, invoicing and collection of fees

The producer car unit is a small unit within the Industry Services division. There is one full-time producer car officer and one person cross-trained in the producer car officer’s duties to cover absences. The producer car officer reports to the Manager, Producer Protection. The processing of producer railway car applications and allocation of cars is a combination of manual and automated processes. Farmers or other authorized parties use an online program to order producer railway cars, but the technology used does not currently allow the application fee to be paid online. Payment acknowledgement letters are automatically generated by the system once the producer car officer enters a "paid" status, and the letters are then mailed or emailed to the farmer. The allocation of cars is performed manually by the producer car officer within the railways' systems (Canadian National or Canadian Pacific). The producer car unit has extensively documented its processes, including breaking down the specific tasks required each day of the week.

Fee payment is a key function in the CGC's application process, as revenue is based on a per car order, regardless of whether the car is ultimately allocated. Application fees may be paid by cheque, credit card (by phone), or electronic funds transfer. The majority of producer railway cars (as many as 75% in 2016-2017) are ordered through an "administrator," who is a licensed party the farmer has authorized to act on their behalf. Because administrators often order a group of cars, they may pay in bulk to reduce calls to the CGC, or may prepay for a number of cars. The producer car officer then applies the payment to individual cars as the orders are made by the administrator.

To verify that the producer car unit's application processing, payment and allocation processes were being followed, we reviewed a total of 25 randomly-selected producer railway car applications. Because payments are manually processed and tend to be received in bulk from administrators, it was difficult to definitively trace all applications to payments (and sample payments to applications). However, we were able to conclude that payments for all of the sample applications were processed appropriately. We performed a calculation to verify the reasonability of revenue collected in relation to cars ordered, which indicated that overall fees were being collected appropriately. We noted exceptions in most situations where applications were cancelled prior to car allocation and the application fee was not charged. As the fees apply to the application and not the allocation of cars, the fee should be charged regardless of whether the order is subsequently cancelled. The resulting missed revenue amount was not significant, but the issue was discussed with producer car management during the audit, and fees for cancelled applications will now be charged.

Although no other errors were noted, we observed that a reconciliation is not performed between fees collected and car orders received, and there is limited review of producer railway car financial records. As the producer car unit handles cheques and has access to a point-of-sale machine, good controls would include periodic reconciliation of cash to application activity by an independent party.

Recommendation 1: Reconciliation

We recommend that the Manager, Producer Protection and the Finance Division strengthen controls over processing and collecting cash payments by reconciling system application and payment information from Information Management and Technology Services, the producer car unit's prepaid application spreadsheet, and bank account information on a periodic basis (frequency dependent on risk tolerance).

Impact: Medium

Objective 2: to determine if producer railway cars are appropriately allocated according to established rules

The CGC is responsible for allocating producer railway cars once the application has been processed. Section 87 (2) of the Canada Grain Act requires that cars are allocated in the order in which complete applications are received. An authorization number is assigned only after payments are received, and cars are allocated starting with the lowest authorization number (first-in-first-out method). Before a car is allocated, the producer car officer confirms that the farmer can load the car during a given shipping week. AES interviewed producer car officers and tested a sample of allocated cars. The methodology was found to be sound and was consistently followed. There were no errors or control deficiencies found in the sample. The new computer application has improved overall controls within the authorization and allocation process. Based on testing and discussions with the producer car officer, a railway car is spotted (delivered by the railroad company) as close as possible to the requested week. Overall, the allocation of the producer railway cars was fair.

To further ensure fairness, the producer car unit also uses the "backlog rule" to allocate cars among producers by limiting the number of cars allocated to a farmer or administrator to two times the maximum car spot at a loading site. For example, a farmer may load up to 10 cars at a 5-car spot. After that, the next farmer in the queue may load cars at that site. AES found that the officers consistently followed the backlog rule.

There is no guarantee that a farmer’s car(s) will be allocated or spotted before the end of the crop year. The transition to the new crop year requires the producer car unit to coordinate with Information Management and Technology Services. AES performed a walkthrough on the transition from crop year 2015-2016 to 2016-2017 and found that outstanding railway cars were carried over to the new crop year. These cars generated a new authorization number and had priority for earliest allocation.

Recommendation

No recommendation is required.

Objective 3: to provide assurance that producer car processes are in compliance with applicable legislation, policies, and orders

The producer car unit acts in accordance with the Canada Grain Act, Canada Grain Regulations and the CGC's own policies for day-to-day work. To supplement the Regulations, the Commission makes and publishes orders which provide additional information on ordering and loading producer railway cars.

The Canada Grain Act and Canada Grain Regulations

The Canada Grain Act requires elevators in western Canada that receive grain directly from western Canadian farmers and terminal elevators that export grain from Canada to be either licensed or exempted from licensing by the CGC. The producer railway car system provides farmers a conveyance option that bypasses at least some aspects of the licensed system and the associated fees. However, approximately 75% of producer railway cars were arranged through a licensed third-party administrator. Producer railway car administrators do not have a grain handling facility but, as they buy grain from farmers, they are also licensed by the CGC under a class established in the Act as "grain dealers". This provides farmers who ship producer railway cars using administrators with payment protection and additional rights under the Act.

Of the approximately 25% of cars that were self-administered (arranged and ordered by farmers themselves) in the 2016 to 2017 crop year, approximately 14% (about 3% of the total) shipped to facilities that were not licensed under the Act because they were outside of Canada, exempted from licensing or unlicensed for other reasons. Farmers shipping to these destinations may be exposed to greater risk than if the grain went to a licensed facility. Risks could include non-payment, scales not properly calibrated at unload, and unregulated grading if CGC grades are used in the contract.

Orders of the Commission

The CGC has historically issued an annual order pertaining to producer railway cars effective on August 1. To comply with the August 1, 2016 order (Order no. 2016-01), producer car officers are required to obtain, “to the satisfaction of the Commission,” confirmation of sale and destination directly from farmers prior to allocating a car ordered by an administrator. Farmers can provide confirmation by phone, email, providing a copy of the contract, or through clicking on an electronic link that indicates their agreement with the cars ordered. Producer car officers can then process the applications once payments are received.

During the audit, we observed that producer car officers consistently requested and received confirmation of sale as mentioned above. However, based on the requirements of Order 2016-01, we expected that physical evidence of the sale (i.e. a copy of the contract) would be collected and verified for each order, which was not the case. In the past, some administrators ordered cars in anticipation of a sale so the confirmation was implemented to ensure an actual sale had taken place. However, since the order’s only stated criteria was “to the satisfaction of the Commission,” it is unclear if the intention of the order was to obtain an actual (physical) confirmation of sale or only to have the farmer personally acknowledge the sale to verify the administrator’s order. Consequently, we could not conclude whether the producer car unit was in compliance with the Commission order.

Since the timing of the audit field work coincided with the timing of the annual order renewal, CGC management and the Commissioners immediately addressed the lack of clarity on the confirmation of sale requirements and made other improvements before issuing a new order pertaining to Producer Railway Cars on July 31, 2017.

Recommendation 2: Compliance

We recommend that a message be added to the producer railway car application reminding farmers to protect themselves by only shipping to licensed facilities or by using other aspects of the producer protection program such as licensed grain dealers.

Impact: Low

Recommendation 3: Producer Railway Car Order

We recommend that the annual Producer Car Order be revised to clarify the requirements for farmers, administrators and the Producer Car unit with respect to confirmation of a sale of grain prior to car allocation. We acknowledge that management has implemented this recommendation prior to completion of the audit.

Impact: Medium

4. Acknowledgements and contacts

We express our appreciation to staff and management of the Industry Services, Finance, and Information Management and Technology Services divisions for their assistance during the course of this audit.

This audit has been reviewed with:

N. Gerelus, Director, Industry Services

Audit & Evaluation Services contact:

B. Brown, Chief Audit Executive

Appendix A – Summary of recommendations and management action plans

The following is a summary of recommendations contained in this report with management's action plans to address each recommendation identified.

- Appendix C: Criteria for determining the impact of audit recommendations

Recommendation	Management action plan
Medium impact	
Recommendation 1: Reconciliation	
We recommend that the Manager, Producer Protection and the Finance Division strengthen controls over processing and collection cash payments by reconciling system application and payment information from Information Management and Technology Services, the producer car unit's prepaid application spreadsheet, and bank account information on a periodic basis (frequency dependent on risk tolerance).	We agree with the recommendation. The Team Leader, Accounting Operations of the Finance Division is currently working with Information Management and Technology Services to develop a report from the Producer Car Application that will provide the necessary information to perform a quarterly reconciliation between the payments received and processed in SAP (the financial system) with the cars applied and approved through the Producer Car Application. The reconciliation will be implemented by March 31, 2018.
Recommendation 3: Producer Car Order	
We recommend that the annual Producer Railway Car Order be revised to clarify the requirements for farmers, administrators and the producer car unit with respect to confirmation of a sale of grain prior to car allocation. We acknowledge that management has implemented this recommendation prior to completion of the audit.	No action required.
Low impact	
Recommendation 2: Compliance	
We recommend that a message be added to the producer car application reminding farmers to protect themselves by only shipping to licensed facilities or by using other aspects of the producer protection program such as licensed grain dealers.	Management accepts this recommendation. Manager, Producer Protection will initiate a Change Request with Information Management and Technology Services to have such a statement included on the producer car application. Action will be complete by March 31, 2018.

Appendix B – Audit criteria

Audit Objective #1: To assess whether the processes are in place to enable efficient and effective controls over processing producer railway car orders, invoicing and collection of fees	**Audit Criterion 1.1:** Applications are processed according to established protocol.
	Audit Criterion 1.2: Only applications from eligible parties are processed.
	Audit Criterion 1.3: Producer Car personnel ensure that fees collected are recorded and complete.
	Audit Criterion 1.4: The fees are reconciled to system reports and bank information as appropriate.
Audit Objective #2: To determine if producer railway cars are appropriately allocated according to established rules	**Audit Criterion 2.1:** A consistent methodology has been developed and is followed for the allocation process.
	Audit Criterion 2.2: Producer Car Officer ensures that producer railway cars are allocated in the order applications are received and backlog rules are followed.
	Audit Criterion 2.3: Crop year carryover is processed correctly.
Audit Objective #3: To provide assurance that producer railway car processes are in compliance with legislation, policies and orders	**Audit Criterion 3.1:** Processes are developed to be in compliance with the Canada Grain Act, Canada Grain Regulations and Commission Orders.
	Audit Criterion 3.2: The CGC has controls to ensure employees and the CGC remains in compliance on a continuing basis.

Appendix C – Impact of recommendations

The following categories have been applied to each recommendation within this report. Categories are defined as follows:

High

Recommendation:

- will improve management controls or control environment for the overall program/process/area/division/etc.
- may take considerable effort to implement within the operational environment or may involve a significant change
- may have a significant financial impact
- likely results in assumption of a substantial risk if not implemented (e.g. decreased efficiency, higher risk of errors, lost cost savings opportunities)

Medium

Recommendation:

- will improve management controls in that area
- will improve efficiency and/or effectiveness of operations in that area
- is not likely to require a significant effort to implement
- may have some financial impact; could be a less significant item that could accumulate over time to create a larger impact

Low

Recommendation:

- promotes a good management practice
- likely improves day-to-day work experience
- likely requires minimal effort to implement
- will have limited financial or operational impact