Audit of Accounts Receivable Management at Health Canada

March 2018

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List of acronyms

ADA	Allowance for doubtful accounts
AR	Accounts Receivable
CFO	Chief Financial Officer
CFOB	Chief Financial Officer Branch
DISC	Department of Indigenous Services Canada
DWORC	Debt Write-off Review Committee
FNIHB	First Nations and Inuit Health Branch
FOD-CFOB	Financial Operations Directorate, Chief Financial Officer Branch
G&Cs	Grants and Contributions
GCIMS	Grants and Contribution Information Management System
HC	Health Canada
HC/PHAC	Health Canada/Public Health Agency of Canada
ICD	Internal Control Division
MAF	Management Accountability Framework
NDS-HECSB	National Dosimetry Services Division, Healthy Environment and Consumer Safety Branch
PCA	Private-sector collection agency
PFM	Policy on Financial Management
PMRA	Pest Management Regulatory Agency
TB	Treasury Board
TBS	Treasury Board Secretariat

Executive summary

What we examined

We examined the management control framework put in place to ensure fair, effective and efficient management of accounts receivable (AR) and minimize the risk of loss.

The audit focused on the policies, processes, and procedures in place for recording, collecting, writing-off and monitoring AR from external parties during fiscal years 2016-17 and 2017-18.

This audit included an examination of the accounts receivable management practices within the First Nations and Inuit Health Branch (FNIHB). However, due to the transfer of responsibilities of FNIHB to the Department of Indigenous Services Canada (DISC), announced on December 4, 2017, no recommendations relating to FNIHB were included in this report. Findings were provided to DISC management in a separate document.

Why it is important

Receivables are important assets of the government that require prudent management. This is integral to achieving the objectives of responsible fiscal management.

The Treasury Board Secretariat's *Management Accountability Framework,* for fiscal year 2015-16, highlighted the importance of, and its expectations for, AR management by including it as an indicator of sound financial management. In addition, the updated Treasury Board *Policy on Financial Management* and the *Directive on Public Money and Receivables* requires Deputy Heads to ensure:

- Governance and oversight over financial management are effective;
- Internal controls over financial management are effective;
- Financial information supports decision making and accountability to Canadians;
- Standardized and efficient financial management practices are in place; and
- The financial management workforce is agile and sustainable.

What we found

We found that a management control framework was in place to support ongoing management of AR. We observed that:

- Oversight of AR existed at both the departmental and branch level;
- Policies established for the management of receivables and the removal of debt were consistent with Treasury Board policies;
- Internal Control Division monitoring of effectiveness of controls related to AR management provided information to support management of risks related to AR management;
- Recording of receivables from cost recovery programs was done on a timely basis; and

- A process for write-offs was in place and is consistent with the requirements of the *Debt Write-off Regulations*.

Management has made efforts to improve the management of accounts receivable. However, opportunities for further improving the management of accounts receivable were identified in the areas of:

- Regular reporting to senior management on collection activities or the collectability of accounts;
- Clarifying roles, responsibilities, and accountabilities of the various players involved in the accounts receivable management process;
- Enhancing guidance and tools to support the collection of outstanding accounts receivable;
- Timely collection action and monitoring of accounts; and
- Enhancing the process for determining the allowance of doubtful accounts.

Management agrees with the recommendations in this report and provided an action plan addressing the agreed upon recommendations to further strengthen the management control framework supporting accounts receivable management.

A- Introduction

Background

1. Receivables are defined in the Treasury Board (TB) *Directive on Public Money and Receivables* as “financial claims incurred through the tax system or arising from accrued revenues transactions, expenses overpayments and other recoverable payments that will result in a future inflow of cash[1].” They are core assets that involve millions of dollars annually and a wide range of transactions. Given this complexity, departments and agencies are expected to manage resources effectively to ensure sound and prudent use of public funds. The Treasury Board Secretariat’s (TBS) Management Accountability Framework (MAF) for fiscal year 2015-16 highlighted the importance of, and its expectations, for accounts receivable (AR) management by including it as an indicator of sound financial management.

2. In addition, the TB *Policy on Financial Management* and the *Directive on Public Money and Receivables*, expects Deputy Heads to ensure[2]:

   - Governance and oversight over financial management are effective;
   - Internal controls over financial management are effective;
   - Financial information supports decision making and accountability to Canadians;
   - Standardized and efficient financial management practices are in place; and
   - The financial management workforce is agile and sustainable.

3. In working to fulfil its mandate, the Department is engaged in activities that may result in the establishment of an AR. These activities are primarily related to the revenues from fees for services of a regulatory nature, fees for rights and privileges, recovery of overpayments from contribution agreements, charges to other government departments, and recoveries such as those related to salary overpayments.

4. The Department’s gross AR balance at the end of fiscal year 2016-17 was $101M. As shown in Table 1, this amount was made up of receivables from external parties, other government departments and agencies, and employee advances. Receivables from external parties accounted for the majority of the AR for the Department. This balance was mainly comprised of recoveries of overpayments from contribution agreements ($29M - 46%), and from revenues from external clients ($32.5M - 51%). AR from other government departments account for 19% of the gross accounts receivable. These receivables relate to the provision of various finance and administrative services to other organizations within the Government of Canada, as well as salary recoveries for employees who have moved to another department or agency. The introduction of the Pay Transformation Initiative and the new pay system (Phoenix) in 2016 resulted in pay challenges, including issues of over-payments and under-payments of employee salaries across all government departments

[1] Appendix A: Definitions of the TB Directive on Public Money and Receivables
[2] Section 4 of the TB Policy on Financial Management

and agencies. Therefore, the amount of employee advances at the Department was nearly $18M. The audit focused solely on accounts receivable from external parties. Receivables from other government departments and agencies were excluded due to the low level of risk associated with the collection of inter-departmental transactions.

Table 1 – Breakdown of Health Canada's Gross Accounts Receivable as at March 31, 2017

	Amount ($'000)	Percentage (%)
External Parties	$ 63,303	63%
Other Government Departments	$19,808	19%
Employee Advances	$17,967	18%
Total	$101,078	100%

5. The Health Canada (HC) and Public Health Agency of Canada (PHAC) *Standard on the Management of Receivables* was developed by the Chief Financial Officer Branch (CFOB). The Standard defined the responsibilities and requirements for the management of accounts receivable within the Department. Responsibility for the management of accounts receivable is a shared responsibility between the program branches, and the Financial Operations Directorate within the Chief Financial Officer Branch (FOD-CFOB). In general, the accounts receivable process consists of three primary activities: recording or invoicing, collection, and write-off. The monitoring of AR occurs within each of these steps.

6. In general, program branches were responsible for identifying and recording the amounts owed to the department, while FOD-CFOB was responsible for collection and monitoring activities. Some branches had responsibility for collection and monitoring of outstanding receivables. These include the First Nations and Inuit Health Branch (FNIHB) for receivables from contribution agreement overpayments, and the Pest Management Regulatory Agency (PMRA). The National Dosimetry Services Division (NDS), within the Healthy Environments and Consumer Safety Branch (HECSB), was also involved in collection activities.

7. For accounts receivable related to recoveries of overpayments on contribution agreements, the FNIHB was responsible for the determination of the amounts to be recovered, collection activities, and monitoring the status of the AR. FOD-CFOB is responsible for recording AR in the departmental financial system (SAP), as well as, the write-off of the receivables where necessary.

8. PMRA was responsible for recording, collecting and monitoring of AR resulting from fees, charges and fines or penalties with respect to pest control products.

9. At the time of this audit, the transfer of responsibility for FNIHB to the Department of Indigenous Services Canada (DISC) was announced as part the new ministerial mandate letters issued by the Prime Minister's Office. FNIHB-related findings were provided to DISC senior management in another document.

B-Findings, recommendations and management responses

Governance

Governance structure and oversight

10. We expected that a governance structure was in place to monitor all activities of the accounts receivable (AR) lifecycle, from recording to collection to eventual write-off of outstanding debts.

11. Oversight is important for ensuring effective financial management processes are in place, and it helps to support the stewardship responsibilities of senior management. This requires an appropriate structure and regular reporting on all phases of the AR lifecycle.

12. We found that oversight of AR existed at both the departmental and branch level. At the departmental level, the Transfer Payment Management Services Section (TPMS) within the Chief Financial Officer Branch reconciled the AR amounts recorded in the departmental financial system (SAP) to the amount of AR recorded in Grants and Contributions Management System (GCIMS). This reconciliation helped to ensure accuracy of information contained in SAP and GCIMS. In addition, TPMS provided reports to the First Nations and Inuit Health Branch (FNIHB) on the value of accounts receivable recorded in GCIMS that did not have a scheduled recovery or recovery plan, which helped to inform management on the risks related to collectability of receivables from G&Cs recoveries. At the Pest Management Regulatory Agency (PMRA), the Agency Management Committee was provided with information on AR at the end of fiscal 2016-17 and mid-year of fiscal 2017-18. Other branches monitored cost recovery revenues to assess their budget impact since these revenues are relied upon to fund operating requirements.

13. In addition, we found that a Debt Write-Off and Review Committee (DWORC) had been in place to provide oversight for the removal of debt. However, we found limited documented evidence to demonstrate oversight of the collection of outstanding non-G&Cs debts. The DWORC reported to the Chief Financial Officer (CFO) and met twice a year to review debt write-off requests, waiver of interest and administrative charges requests, and made recommendations to the CFO.

14. While its primary responsibility was to formally review debt write-off requests, the Committee also received additional information relating to receivables and write-offs by region, and aged receivables by program and region. We did not find regular reporting to either the DWORC or to senior management on collection activities or the collectability of accounts. The Financial Operations Directorate, Chief Financial Officer Branch's (FOD-CFOB) AR Unit provided monthly aging reports to cost recovery areas. However, there was minimal direction included with these reports to indicate how program staff could use them to help determine an appropriate recovery strategy. Interviews with staff indicated that these reports were of limited use.

15. Through the analysis performed for this audit, we observed a number of areas that would have benefited from greater oversight. Specifically, we observed that nearly $1.6M of

receivables from a Health Canada program, which ended in 2014, has been deemed uncollectible and may need to be written-off since the debt was accumulated prior to 2009. Additionally, over half of the receivables for the Pest Management Regulatory Agency (PMRA) were over two years old. Also, $2M in recoveries from G&Cs overpayments to recipients in the British Columbia (BC) region will need to be assessed to determine if it should be written off given that the regional office was closed in 2013, when responsibility for First Nations health programming in BC was transferred to the First Nations Health Authority (FNHA). During this transition, documentation to support the receivables was displaced and had been archived or destroyed due to the amount of time that has passed since this transfer. We observed overall that the write-off of uncollectible accounts at the Department increased significantly from $282K in fiscal year 2014-15 to over $1.4M in fiscal year 2016-17, and at the time of the audit, nearly 25 percent of the outstanding items were over three years old, which exceeded the time limit for legal action imposed in most provinces.

16. Improved reporting on AR management would provide better information to support decision-making, and would further enhance oversight within the governance framework.

Recommendation 1

The Chief Financial Officer (CFO) enhances reporting on accounts receivable to help in the management of risks for the collection and collectability of outstanding accounts receivable.

Management response

Management agrees with recommendation. The Financial Operations Directorate (FOD) will implement regular reporting to the CFO and Deputy Chief Financial Officers (DCFO) showing the status of outstanding accounts receivable by type and by age.

Guidance and tools

17. We expected that internal policies and guidance tools were available to employees to discharge their responsibilities as they relate to receivables.

18. Through the FOD-CFOB, multiple governing documents were developed to provide direction for the management of receivables. We examined these documents and determined that relevant roles and responsibilities denoted in the Health Canada/Public Health Agency of Canada (HC/PHAC) *Standard on Management of Receivables* and the *Standard on Removal of Debt* were consistent with Treasury Board (TB) expectations, and were available to employees via the intranet.

19. We identified opportunities for improvement in regard to the Standards. First, the HC/PHAC *Standard on Management of Receivables* included requirements for an assessment of the creditworthiness of customers where necessary; use of collection activities that were appropriate and cost-effective, including the use of private-sector collection agencies (PCA) or provincial small claims court; or suspension of debtor accounts when it appeared debt recovery was unlikely to occur in a timely manner. However, program and accounting operations staff indicated that creditworthiness assessment of a client was not performed prior to conducting business with them, nor had any debtor accounts been suspended as a result of debtor non-payment. We also noted that there was insufficient guidance on what constitutes appropriate and cost-effective collection activities, and there was a lack of guidance documents to assist accounting operations staff in performing these collection activities in an effective and efficient manner.

20. Second, the *Standard on Removal of Debt* allowed for the write-off of debt when the costs of collection were not justifiable in relation to the amount of the debt, or the probability of collection. It also allowed for the reinstatement of debt previously written-off when it was known that the debtor's financial position had improved, and that the debtor was capable of paying the debt. However, no guidance was provided on how to determine when the costs of collection were unjustifiable, nor was responsibility established for determining the change in the debtor's financial position.

21. Third, we also noted that improvements were required in clarifying the roles and responsibilities of the various players involved in the AR management process. As per the HC/PHAC *Standard on Management of Receivables*, collection activities were the responsibility of the accounting hubs. However, we observed that this was not the case in several instances. For recoveries related to contribution agreement overpayments, program staff within FNIHB was responsible for monitoring and following up on outstanding AR balances. PMRA and the National Dosimetry Services Division (NDS-HECSB) also performed collection activities. This inconsistency between the Standard and actual practices could result in gaps in the collection process and redundant activities, leading to inefficiency in the collection process.

22. We also found that at the PMRA, where the AR function was performed in-house, a standard operating procedure document to describe the roles and responsibilities of the staff was not developed. This, coupled with staff turnover, meant that there was minimal AR collection activity performed during fiscal year 2016-17. In addition, we noted that NDS-HECSB had developed a collections procedure document, but the timelines for collection action were not aligned with those of the HC/PHAC *Standard on Receivable Management*. The TB *Policy on Financial Management* notes that departments should have standardized financial management practices. Therefore, alignment of collection practices within the Department would be encouraged.

23. Management has indicated that an exercise is currently under way to explore options to consolidate the accounts receivable management practices across the department, including moving responsibility for PMRA's accounts receivable to CFOB.

24. Overall, we found that internal policies were in place and available to employees; however, improvements are required to enhance oversight and guidance.

Recommendation 2

The Chief Financial Officer (CFO) amends guidance documents and procedures to enhance accounts receivable management, including:

- standardizing and clarifying roles and responsibilities for the re-instatement of debts, and the monitoring and collection of debts related to recoveries of contribution agreement overpayments;
- developing guidance documents to facilitate collection activities such as locating the debtor, and determining if the debtor is capable of repaying the debt; and
- establishing a method for determining when the cost of collection is not justifiable in relation to the amount of the debt or the probability of collection.

Management response

Management agrees with the recommendation.

The Financial Operations Directorate (FOD) will refine the *Standard on Receivable Management* to further clarify roles and responsibilities for items such as the on-going monitoring and collection of debts related to recoveries of contribution agreement overpayments.

FOD will prepare a guidance document to support accounting hub staff in determining which advanced collection activities to pursue based on the nature of the debt. The document will include direction on considering the cost of the collection when determining the appropriate recovery activity.

Recommendation 3

The Executive Director, Pest Management Regulatory Agency (PMRA) finalizes the standard operating procedures for accounts receivable and ensure alignment with the Health Canada/Public Health Agency of Canada *Standard on Management of Receivables*.

Management response

Management agrees with the recommendation.

The PMRA will finalize the Standard Operating Procedures (SOP's) to fully implement Section 23 of the *Pest Control Products Act* (PCPA) for outstanding accounts receivable.

Recommendation 4

The Assistant Deputy Minister, Healthy Environments and Consumer Safety Branch (HECSB), ensures collection procedures are consistent with the Health Canada/Public Health Agency of Canada *Standard on Management of Receivables*.

Management response

Management agrees with the recommendation.

The collection activities and procedures of HECSB's National Dosimetry Services (NDS) are generally consistent with the HC/PHAC *Standard on the Management of Receivables*. However, the schedule used by the program for follow-up on overdue accounts is limited by the functionality of its current dosimetry management system (DMS) software, which initiates client follow-up at 60 days overdue instead of at 30 days as outlined in the Standard.

While replacing the system is an objective of the program, given the current priority setting process recommended by the Treasury Board and the departmental priorities, it is not feasible to implement a new solution. Therefore, until the DMS replacement software is implemented, the program will continue to undertake collection activities and procedures as described in its current operating procedures.

Risk management

25. We expected to find mechanisms, including reporting on factors that impact risk of collection or collectability of account, were in place to identify, address and report on risks related to recording, collection, write-off and remission[3] of receivables.

26. These reports are an important management tool for providing the information required to ensure that measures to mitigate risk are effective and to support continuous improvement of the AR management process.

27. We noted that the Internal Control Division (ICD), within CFOB, conducted tests of operating effectiveness of controls related to AR management. These tests by ICD served as a mechanism to inform senior management on some of the risks related to AR management, such as segregation of duties and adequacy of supporting documentation. Further, the HC/PHAC *Standard on Management of Receivables* referenced mechanisms to address risks related to AR, such as the assessment of the creditworthiness of customers or suspension of debtor accounts. However, through interviews we found that these mechanisms were not utilized.

[3] As per the *Financial Administration Act* (section 23 (2),and 23(8)), Remission of debt occurs when the Governor in Council considers that the collection of the other debt is unreasonable or unjust or that it is otherwise in the public interest to remit the other debt. A remission has the effect of a pardon for the offence for which the penalty was incurred, and thereafter the offence has no legal effect prejudicial to the person to whom the remission was granted.

28. PMRA has implemented new measures to mitigate risk of non-collection of accounts receivable. PMRA had established procedures that will enable it to cancel or amend registrations or refuse service when an outstanding debt is present.

29. As indicated previously in the section on Governance, there was limited reporting to inform management on the AR management process. We did not observe the reporting of factors that impact collectability of accounts and would inform management of risks related to the AR collection.

30. Appropriate reporting is necessary to help management identify and assess risks of non-collection, as well as develop measures to mitigate the risk of loss (see Recommendation 1).

Internal controls

Recording

31. Recording of the receivable was primarily the responsibility of the program branches. Timely recording of receivables helps to ensure collection action is taken when customer invoices become overdue.

32. Accounts receivable can be the result of revenue generating activities or recovery of overpayments to suppliers, employees, or G&Cs recipients.

33. ICD-CFOB conducted tests to verify the timeliness and accuracy of revenues recorded from revenue generating activities and found that the revenues were properly recorded.

34. The majority of the Department's receivables from recoveries of contribution agreement overpayments were related to First Nations and Inuit Health Branch (FNIHB) programming.

35. This audit included an examination of the accounts receivable management practices within FNIHB. However, due to the transfer of responsibilities of FNIHB to the Department of Indigenous Services Canada (DISC), announced on December 4, 2017, no recommendations relating to FNIHB were included in this report. These findings were provided to DISC management in a separate document.

Collections

36. Timeliness of collection actions is critical to maximize the recovery of receivables in the shortest period of time possible, thereby properly discharging departmental stewardship responsibilities. The TB *Directive on Public Money and Receivables* also requires departments to take timely and cost-effective collection actions to pursue receivables. Departments are also expected to have standardized and efficient financial management practices in place.

37. At the Department, the process for collection of receivables involved an array of activities that were designed to recover debts to the Crown at a minimal cost and minimize the risk of loss. These activities included direct contact with the debtor, monitoring of outstanding

balances, and review of accounts to ensure accuracy of recorded information. Collection activities were decentralized and vary depending on the type of client, such as, a receivable arising from operating authorities, as opposed to recoveries of overpayments from contribution agreements. As noted below, some branches also have responsibility for the collection of outstanding debts.

38. Through efforts to streamline and standardize financial operating processes, FOD-CFOB consolidated activities related to the processing of accounts receivable and accounts payable transactions and centralized 13 accounting offices to two accounting hubs in 2012. This transition led to challenges with respect to some receivables, as supporting documentation was lost or destroyed.

Receivables from Operating Authorities

39. The accounting hubs, within the FOD-CFOB, were responsible for collection of AR related to operating authorities, such as program revenues for both the Department and PHAC. PMRA also had responsibility for the collection of debt related to their respective revenues, and NDS-HECSB performed some of their own collection activities. As noted in the section on Governance, minimal collection activities were performed at PMRA, and collection procedures at NDS-HECSB were different than those established in the HC/PHAC *Standard on Management of Receivables*.

40. At the time of this audit, approximately half of the non G&Cs related receivables were less than 30 days old. Therefore, no collection action was required. For the remainder, these were considered overdue and collection action was required.

41. Collection actions by the accounting hubs typically entailed sending a series of reminder letters (a process referred to as dunning), and attempting to reach debtors via phone or email. Advanced collection procedures, such as the use of PCAs, were utilized if initial attempts to reach the debtor were unsuccessful. The status on the number of times an invoice had been dunned was tracked in the departmental financial system (SAP). Based on a review of the data in SAP, the majority of outstanding receivables were not dunned. Furthermore, for customer accounts that were identified as being dunned, we found that dunning letters were not initiated within the timelines established in the HC/PHAC *Standard on Management of Receivables* (30, 60 and 90 days).

42. The accounting hubs internal collection procedures stated that accounts over 120 days overdue were to be sent to a PCA, and were to be returned after 180 days (six months) if collection efforts by the PCA were not successful. We compared the aging balance to the list of customer accounts with a PCA, and found that five percent of customer accounts over 120 days were sent to a PCA. Additionally, from a sample of accounts that were with a PCA, at the time of this audit, we found that on average they were sent to a PCA 930 days after the invoice due date. The delay in sending accounts to a PCA may have decreased the probability of fully recovering outstanding accounts receivable, thereby increasing the risk of loss.

43. We found, through a review of customer accounts with a PCA, that approximately 90% have been there for more than 180 days, with some accounts as long as ten years. The longer

that customer accounts remained with the PCA, the less likely the Department could take timely action in managing accounts, such as suspending debtor's accounts or no longer authorizing further credit to the debtor, or providing goods or services, use of facilities, or rights or privileges to the debtor. Interviews indicated that, once receivables were sent to a PCA, there were minimal ongoing communication exchanges on the status of the receivables, and customer accounts were not actively monitored. At the time of this audit, the Accounting Hubs started to take measures to reduce the number of accounts with the PCA. As of August 2017, we noted that the number of customer accounts remaining with the PCA for more than 180 days was reduced to approximately 60%, and the average number of days reduced to 400.

44. It was observed that progress has been made to address long standing overdue accounts, A review of an aging report on overdue receivables showed that accounts with amounts over 365 days old had been reduced from 37 percent in 2015-16 to 25 percent during the period within the scope of this audit.

45. Overall, progress has been made to reduce receivables over one year old; however, improvements are required to ensure timely collection action to further help minimize the risk of loss.

Recoveries of Overpayments from Contribution Agreements

46. Recovery of overpayments from contribution agreements was the responsibility of program staff. Once notified of an overpayment, recipients were provided the option to repay the funds in full, or a recovery plan could be established to set-off against future agreements. Where no recovery plan had been established, follow-up of outstanding amounts were performed as part of the regular G&Cs recipient monitoring process. In cases where a recovery plan was negotiated, details of the plan were entered into GCIMS and recovery was facilitated through automatic deduction from outgoing payments to the recipient and no further collection effort was required. Accounting hubs reviewed and approved the information entered in GCIMS prior to recording the receivable in the departmental financial system (SAP).

47. The majority of the recoveries were related to the First Nations and Inuit Health Branch (FNIHB) contribution agreements. As noted in the section on Recording, due to the transfer of responsibilities of FNIHB to the Department of Indigenous Services Canada (DISC), no recommendations relating to FNIHB were included in this report. These findings were provided to DISC management in a separate document.

Interest Calculation and Account Monitoring

48. According to the TBS Guideline on Interest and Administrative Charges, when an account is overdue or a payment is late, departmental officials will charge interest compounded monthly at the average bank rate plus three percent (3%). The audit team conducted testing on a sample of transactions to determine whether interest was appropriately charged. We found that no interest was charged on approximately 50 percent of the overdue accounts. Although the amount of uncharged interest was relatively small, improvements to the process of charging interest should still be made, as they are receivables due to the Crown and should be collected. With respect to recoveries of G&Cs overpayments we found that

interest was calculated on overdue accounts in SAP. However, this information was not reflected in GCIMS. Therefore, this information was not available to the program staff that was responsible for following up on outstanding amounts. As a consequence, recipients were often unaware that there may be unpaid interest charges on their account. Management indicated that efforts were being made to rectify the situation.

49. The HC/PHAC *Standard on Management of Receivables* identified the accounting hubs as being responsible for performing periodic reviews of debts to ensure that the information in SAP was accurate and up-to-date, and to ensure that money received is posted to the correct customer or vendor account. This review also ensures timely clearing of customer payments against customer invoices, so that interest is only charged on past due invoices. Through analysis of aging transactions, we found almost eight percent of the Department's transactions took longer than ten days for a payment to be matched to an invoice in a customer's account. Therefore, additional work may be required to cancel interest transactions.

50. Furthermore, a review of client account balances in SAP revealed that seven percent of the accounts had outstanding balances made up of only interest charges. In addition, we noted that there were 564 customer accounts that had credit balances greater than one year old. Although some of these debts were relatively small as it related to unpaid interest charges, they were receivables due to the Crown and should have been collected, failing which they should have been written off. The credit balances represent invoicing errors or overpayments by the customer, and therefore, should have been returned to the customer.

51. As noted in the HC/PHAC *Standard on Management of Receivables*, when it appeared unlikely that recovery of a debt would occur in a timely manner, or the likelihood of recovering the debt was low, the debtor's account could have been suspended. When a debtor's account was suspended, the Department would no longer authorize further credit to the debtor, or provide goods or services, use of facilities, or rights or privileges to the debtor. The accounting hubs were responsible for suspending a debtor's account(s) in SAP. The audit team observed 53 instances where an invoice was posted in the customer's account, even though there was an invoice outstanding for at least one year. We found that no communication exchanges were held with the programs to suspend accounts, and when accounts were returned from the collection agency, they were not suspended. As a result, programs continued to conduct business with a client despite past collection issues.

52. Analysis of the information provided to the Debt Write-Off and Review Committee (DWORC) provided valuable insight into the effectiveness of past collection activities. We noted several instances where write-off of customer accounts was not initiated until several years after it had been statute-barred. Overall, the majority of the write-offs in fiscal 2016-17 were related to debts that were, on average, eight years old. Management indicated that a concentrated effort was made to write-off debts that were no longer collectible.

53. As receivables are largely considered to be a short-term asset, they are normally expected to be settled within one year. Management has made progress in addressing delinquent customer accounts. However, the results of the audit indicate that additional efforts are required to ensure timely collection of receivables.

Recommendation 5

The Chief Financial Officer (CFO) pursues accounts receivable greater than one year old in order to take timely actions to recover or write-off debts and enhances the process for determining an allowance for doubtful accounts.

Management response

Management agrees with the recommendation.

The quarterly reporting to the CFO and Deputy Chief Financial Officers (DCFO) will clearly reflect accounts receivable that are greater than one year old for ease of reference, and will be used to target collection efforts. The results of collection actions will also be shared with Corporate Accounting on a quarterly basis for consideration in the determination of the allowance for doubtful accounts.

Write-off and remission

54. We expected to find that a process was in place and followed for the timely write-off, remission, and forgiveness of debts, as well as waiver of interest or administrative charges of departmental accounts receivable that are uncollectible.

55. In the government context, write-off of debt allows the departments and agencies to accurately reflect the net realizable value of receivables by removing accounts determined to be uncollectible. It does not release the debtor from the obligation to pay, nor does it affect the Department’s right to enforce collection in the future. On the contrary, the remission and forgiveness of debt extinguishes the debt and waives the right of Her Majesty to reinstate the debt. During the scope of the audit, no remission or forgiveness of debts were submitted by the Department on any of their uncollectible accounts.

56. The *Debt Write-off Regulations, 1994*, require departments to establish a formal process for the writing-off of debt, and prescribe the criteria for debt write-off. Namely, that all reasonable collection action has been taken, all possible means of collection have been exhausted, and there is no possibility now, or in the foreseeable future, to collect through set-off prior to writing off accounts receivable that have not been settled in full. The Regulations also allow departments to write-off debts when the cost of collection and other administrative costs are not justified in relation to the amount of the debt and the probability of collection.

57. The TB *Directive on Public Money and Receivables* further requires departments to take timely action for write-off, remission or forgiveness of debts, or waiver of interests or administrative charges, when a receivable is not settled in full. It defines debt write-off as an accounting action that reduces the amount of accounts receivable of a department or

agency regarding a debt, or a part of a debt, that has been determined to be uncollectible. It does not release the debtor of the obligation to pay, nor does it affect the right of the department to enforce collection in the future. In addition, departments and agencies are expected to record allowances for doubtful accounts promptly and accurately.

58. We examined the process for write-offs and found it to be consistent with the requirements of the *Debt Write-off Regulations*.

59. We also reviewed a sample of write-offs approved in fiscal year 2016-17, and found that in all cases, they were properly approved. However, we found that write-offs were not performed on a timely basis. As noted previously, the *Debt Write-Off Regulations* permits departments to write-off debt owed to the Crown under certain circumstances, including when it is statute barred. In Canada, the limit is between two to six years (with two years being the most prevalent). From the sample of write-offs examined, there were numerous instances where the transaction approved for write-off was more than four years after the provincial limit on legal proceedings. In many cases we noted a lack of rigor in the management of, and follow-up on, outstanding debts, as indicated in the section on Collections.

60. Management indicated that, prior to the consolidation of accounting offices, there were different accounts receivable management practices among the different offices. As a result, the accounting hubs assumed responsibility for many old outstanding receivables, and efforts were being made to write-off the older debts.

61. Allowance for doubtful accounts (ADA) are management's best estimate of the amount of accounts receivable that will not be collected. This allows management to anticipate potential problem accounts, develop appropriate corrective actions, and also provides a more accurate picture of the collectability of the accounts receivable. We found that an ADA was recorded at year-end for financial statement purposes. Corporate Accounting and Reporting (CAR) reviews historical data of receivable transactions and applies percentages to the aging of outstanding items to adjust the allowance for doubtful accounts at the departmental or agency level, which helps to mitigate risks to financial reporting.

62. Knowledge of specific customer accounts gained through the collection and monitoring process performed by the accounting hubs would be valuable for informing the determination of an ADA that is more reflective of the collectability of accounts. However, we observed that the current methodology does not fully utilize the information gained through the collection process.

63. Overall, debt write-offs were consistent with the requirements of the *Debt Write-Off Regulations*. However, improvements are required in assessing the probability of collection, in order to better determine an allowance for doubtful accounts (see Recommendation 5).

C-Conclusion

64. We concluded that there was an adequate management control framework in place to support ongoing management of accounts receivable. We observed that:

- Oversight of AR existed at both the departmental and branch level;
- Policies established for the management of receivables and the removal of debt were consistent with Treasury Board policies;
- The Internal Control Division's monitoring of effectiveness of controls related to AR management provided information to support management of risks related to AR management;
- Recording of receivables from cost recovery programs was done on a timely basis; and
- A process for write-offs was in place and is consistent with the requirements *Debt Write-off Regulations*.

Management has made efforts to improve the management of accounts receivable. However, opportunities for further improving the management of accounts receivable were identified in the areas of:

- Regular reporting on collection activities or the collectability of accounts;
- Clarifying roles, responsibilities, and accountabilities of the various players involved in the AR management process;
- Enhancing guidance and tools to support the collection of outstanding accounts receivable;
- Timely collection action, and monitoring of accounts; and
- Enhancing the process for determining the allowance of doubtful accounts.

The areas for improvement noted in this audit report will collectively strengthen the effectiveness of accounts receivable management.

Appendix A – Scorecard

Audit of Accounts Receivable Management at Health Canada			
Criterion	**Rating**	**Conclusion**	**Rec #**
Governance			
1.1 Governance structure and oversight	Needs Minor Improvement	Defining and formalizing reporting requirements related to the collection activities and collectability of accounts receivable (AR) would further enhance oversight within the governance framework.	1
1.2 Guidance and tools	Needs Moderate Improvement	Internal policies were in place and available to employees; however, improvements are required to enhance guidance.	2, 3, 4
Risk Management			
2.1 Management of risk	Needs Moderate Improvement	Enhanced reporting would help management identify and assess risk of non-collection, as well as develop mitigating measures to reduce the risk of loss.	1
Internal Controls			
3.1 Recording	Needs Minor Improvement	Timely identification and recording of G&Cs recoveries is required.	*
3.2 Collections	Needs Moderate Improvement	As receivables are largely considered to be a short-term asset, they are normally expected to be settled within one year. The results of the audit indicate that improvements are required to ensure timely collection of receivables.	5
3.3 Write-off and remission	Needs Minor Improvement	Write-offs of accounts receivable were appropriately authorized; however improvements could be made to enhance the estimation of uncollectible accounts.	5

* no recommendations were made in this report to address the noted observations as responsibility for the First Nations and Inuit Health Branch have been transferred to the newly created Department of Indigenous Services Canada (DISC). Findings were provided to DISC management in a separate document.

Satisfactory	Needs Minor Improvement	Needs Moderate Improvement	Needs Improvement	Unsatisfactory	Unknown; Cannot Be Measured

Appendix B – About the Audit

Audit Authority

This audit engagement was identified in the Office of Audit and Evaluation Risk-Based Audit Plan 2017-2020 (Three Years). The audit plan was endorsed by the Health Canada's and the Public Health Agency of Canada's Departmental Audit Committees and approved by the Associate Deputy Minister at Health Canada and the President of PHAC. The project will be executed under the authority of Office of Audit and Evaluation.

Audit Objective

The objective of the audit was to assess the management control framework in place to ensure accounts receivable are managed fairly, efficiently and effectively to recover such receivables and minimize the risk of loss.

The lines of enquiry for this audit are presented below.

Audit Scope

The audit focused on the framework and processes in place for recording, collecting, writing-off and monitoring accounts receivable during the 2016-17 and 2017-18 fiscal years.

The audit focused solely on accounts receivable from external parties. Receivables from other government departments and agencies are excluded due to the low level of risk associated with the collection of inter-departmental transactions.

The scope also did not include a review of pay-related receivables, including employee advances, resulting from the Phoenix Pay Transformation Initiative (PTI). The Treasury Board Secretariat is working with departments and agencies to monitor the PTI situation. As well, cost recovery revenues from the Health Products and Food Branch were excluded as they were examined in a prior audit.

This audit was not designed to express an opinion on the accuracy of the financial accounts receivable information reported in the departmental financial statements.

Audit Approach

The audit was conducted in accordance with the Government of Canada's *Policy on Internal Audit*, to examine sufficient and relevant evidence, and obtain sufficient information and explanations to provide a reasonable level of assurance in support of the audit conclusion.

The audit methodology included the examination and review of documentation, policies, standards, guidelines, processes, procedures and framework, as well as interviews, and detailed testing and analysis. All work was conducted in the National Capital Region.

Statement of Conformance

In the professional judgment of the Chief Audit Executive, sufficient and appropriate procedures were performed and evidence gathered to support the accuracy of the audit conclusion. The audit findings and conclusion are based on a comparison of the conditions that existed as of the date of the audit, against established criteria that were agreed upon with management. Furthermore, the evidence was gathered in accordance with the *Internal Auditing Standards for the Government of Canada* and the *International Standards for the Professional Practice of Internal Auditing*. The audit conforms to the *Internal Auditing Standards for the Government of Canada*, as supported by the results of the quality assurance and improvement program.

Lines of enquiry and criteria

Audit of Accounts Receivable Management at Health Canada	
Criteria Title	**Audit Criteria**
Line of Enquiry 1: Governance	
1.1 Governance structure and oversight	Effective governance structure processes are in place to adequately monitor the life cycle of accounts receivable and support oversight and decision-making.[1]
1.2 Guidance and tools	Internal policies, standards, and guidance tools are available to employees to discharge their responsibilities as they relate to receivables, as well as foster compliance with relevant policies and regulations.[2]
Line of Enquiry 2: Risk management	
2.1 Management of risk	Mechanisms, including management reporting, are in place to identify, address and report on risks related to recording, collection, write-off and remission of receivables. [4]
Line of Enquiry 3: Internal controls	
3.1 Recording	A defined process is in place to ensure that all receivable transactions and related allowances for doubtful accounts are promptly and accurately recorded in the accounts of the department. [2]
3.2 Collections	A process is in place to ensure timely and cost-effective collection actions for pursuing receivables and overpayments.[2,3]
3.3 Write-off and remission	A process is in place for taking timely action for write-off, remission or forgiveness of debts, or waiver of interests or administrative charges, when a receivable is not settled in full.[2]

Information Sources:

1 TBS Policy on Financial Management (April 2017).
2 TBS Directive on Public Money and Receivables (April 2017).
3 TBS Guideline on Collection of Receivables (October 2009).
4 TBS Audit Criteria related to the MAF: A Tool for Internal Auditors (March 2011).