

**Insurance Claims & Recoveries
Final Audit Report
Report Nr. 11/11
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Audit Team:

Evelyn Tarsky-Abrams
Allison Lowe

Vice President Internal Audit

Monica Ryan

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Introduction

In accordance with our FY 2011 Audit Plan, EDC Internal Audit performed an audit of the Insurance Claims & Recoveries process. The main activities within this process include monitoring of overdue balances owed to EDC policyholders, performing loss mitigation activities, verifying the eligibility of policyholder claims, processing claim payments, and pursuing recovery of overdue balances. For the fiscal year ended December 31, 2010 (FY 2010) EDC paid insurance policyholders approximately \$126 MCAD in claims and recovered \$36 MCAD of overdue balances. Claims related recovery costs for FY 2010 were approximately \$2 MCAD. Estimated recoverable insurance claims at the end of 2010 were approximately \$92 MCAD.

Audit Objectives & Scope

The overall objective of the audit was to identify the key risks that could materialize within the Claims & Recoveries process and evaluate the design and operating effectiveness of the controls in place to mitigate these risks. Segregation of Duty (SOD) conflicts were noted while evaluating the design effectiveness of controls surrounding the processing of claims and claims related recovery expenses. In addition, an anonymous communication was received during the course of the audit which we considered and dealt with as a complaint under the Public Servants Disclosure Protection Act (PSDPA). The complaint stated that certain employees within the Claims & Recoveries Department (CARD) had misused EDC funds and that a CARD employee accepted a gift from a supplier. Accordingly, additional audit testing was performed to understand the impact, if any, of the SOD conflicts and to also determine if the complaint was accurate. Claims and recovery activities pertaining to Trade Finance Obligations (TFO) were excluded from the scope of this audit. Audit fieldwork was performed from February through June 2011.

Internal Audit Opinion

In our opinion, ***Opportunities Exist to Improve Controls***¹ surrounding the Insurance Claims & Recoveries process. We found that key transactional and monitoring controls within the process had been designed but were not being executed. Immediate action was taken by management

¹ Our standard audit opinions are as follows:

- **Strong Controls:** Key controls are effectively designed and operating as intended. Best in class internal controls exist. Objectives of the audited process are most likely to be achieved.
- **Well Controlled:** Key controls are effectively designed and operating as intended. Objectives of the audited process are likely to be achieved.
- **Opportunities Exist to Improve Controls:** One or more key controls do not exist, are not designed properly or are not operating as intended. Objectives of the process may not be achieved. The financial and/or reputation impact to the audited process is more than inconsequential. Timely action is required.
- **Not Controlled:** Multiple key controls do not exist, are not designed properly or are not operating as intended. Objectives of the process are unlikely to be achieved. The financial and/or reputation impact to the audited process is material. Action must follow immediately.

during the audit to strengthen controls and oversight of activities such as travel expenses, supplier selection, claim payments and recovery expenses. The timeliness with which management took corrective action has been considered in arriving at our opinion.

Audit Findings & Recommendations

1. Claims Related Travel Expenses

Travel by CARD employees may be necessary as part of the insurance claims recovery process in which case the travel costs are recorded as Claims Related Expenses. During the audit, an anonymous communication was received that certain employees within the CARD team were misusing EDC funds by submitting personal travel expenses as claims related travel expenses and being reimbursed. After reviewing the related travel expenses, information in the anonymous communication was found to be correct and a wrongdoing under the PSDPA was found to have occurred. Corrective action was and is being undertaken by EDC. For example, additional controls have since been implemented to ensure greater oversight of travel expenses. A travel expense checklist is now being completed and submitted for approval with each travel expense claim. The checklist provides the expense approval authority the reason for the travel, duration and type of expenses incurred. In addition, business trips involving both claims related travel and other business travel must now be approved in advance of the travel.

Rating of Audit Finding - Major²

Action Owner – Director CARD

Due Dates – Completed

2. Segregation of Duties Surrounding CARD Supplier Management Activities

Segregation of duties is the concept that the flow of transactions and related activities should be designed so that the work of one individual is either independent of, or serves to check on, the work of another. In general, the principal incompatible duties to be segregated are: custody of assets, authorization/approval of related transactions affecting those assets, and recording or reporting of related transactions. During the audit, we found SOD conflicts with respect to

² The ratings of our audit findings are as follows:

- **Major:** a key control does not exist, is poorly designed or is not operating as intended and the financial and/or reputation risk is more than inconsequential. The process objective to which the control relates is unlikely to be achieved. Corrective action is needed to ensure controls are cost effective and/or process objectives are achieved.
- **Moderate:** a key control does not exist, is poorly designed or is not operating as intended and the financial and/or reputation risk to the process is more than inconsequential. However, a compensating control exists. Corrective action is needed to avoid sole reliance on compensating controls and/or ensure controls are cost effective.
- **Minor:** a weakness in the design and/or operation of a non-key process control. Ability to achieve process objectives is unlikely to be impacted. Corrective action is suggested to ensure controls are cost effective.

supplier management activities. Specifically, individuals within the CARD team were responsible for selecting preferred suppliers, authorizing their use on individual claim files, recording supplier expenses and approving these expenses. In some cases, this SOD conflict created a lack of oversight with respect to value for money. Furthermore, during the audit an anonymous communication was received that a gift had been received and accepted by a CARD employee from a CARD supplier. Information in the anonymous communication was found to be correct. Corrective action was and is being undertaken by EDC. Supplier selection has been transferred to an independent function. The process for selecting preferred suppliers is currently being reviewed.

Rating of Audit Finding - Major

Action Owner – Director CARD

Due Dates – All actions to be implemented by Q1 2012

3. Approval of Policyholder Claims & Claims Related Expenses

The current process for approving payment of policyholder claims <\$2 MCAD and claims related recovery expenses <\$1 MCAD does not include adequate SOD between approving, recording and issuing payments. This SOD conflict has created a lack of oversight including inadequate review of supporting documentation prior to authorizing payments. We also found that certain non-standard payments were made such as payments for losses not covered by the exporter's policy or reimbursements in excess of the policyholder's co-insurance ratio. In some cases, claim payments and payments for claims related recovery expenses were made to policyholders in the absence of proper supporting documentation. Payments were also made to policyholders before the loss admissibility date or after the deadline for submitting claims. Furthermore, exception letters were not always issued to policyholders in these cases which could create an expectation that payments would be made in the future in similar situations.

Based on these findings, Internal Audit has worked with management to identify appropriate corrective actions which are now being implemented. SOD conflicts will be eliminated through independent payment verification procedures. Claim summaries will be prepared and submitted to the relevant approval authority to ensure information that may impact the decision to approve a payment is raised with and understood by the approval authority. Exception letters will be issued to policyholders explaining the one-time rationale for any non-standard payments. Appendix O of GEN-002, which outlines the approval levels for claim payments and claims related expenses, will be reviewed to ensure parameters for the issuance of non-standard payments are clearly defined including who has authority to approve such payments. Finally, a general review of approval authorities is being performed within CARD to ensure assigned authorities are commensurate with experience, knowledge and skills.

Rating of Audit Finding - Major

Action Owners – Director CARD, & Director Cash Management, Taxation & Corporate Insurance

Due Dates – All actions to be implemented by Q2 2012

4. Estimated Recoverable Expense Claims

Included in EDC's Balance Sheet under Other Assets is a recoverable insurance claims asset. The balance at December 31, 2010 was \$92 MCAD and is derived from the debt recovery estimate recorded in the Claims & Recoveries System (CRS). We reviewed the recovery estimate in CRS for a sample of claims and found that support does not always exist for the original recovery estimate that is assigned to the claim and that the original recovery estimate is not always updated to reflect current recovery prospects. We have recommended that a quarterly review be performed of estimated recoverable claims. The review should include specific rationale for all recovery estimates greater than a selected threshold. Estimates should be reviewed and approved by Insurance Accounting.

Rating of Audit Finding - Major

Action Owner – Director CARD, in collaboration with Director Corporate Accounting

Due Dates – All actions to be implemented by Q4 2011

5. Management of Bonding Claims

EDC enters into agreements with external bonding companies in order to issue bonds for our policyholders at EDC's request with EDC's full indemnity. Under the terms of these agreements, a fee is paid to EDC's partner for issuing the bond and for administering claims. During the audit, we found that CARD advances funds to the bonding company in anticipation of settling claims without first obtaining supporting documentation and are incorrectly recording these advances as claim payments. Accordingly, there is no tracking of how or if the advance was used. We have recommended that management clarify the circumstances under which funds are to be advanced to bonding partners including approval authorities based on the amount forwarded and duration of the advance. A process should also be implemented to track advance payments, draw-downs and to recover unused funds on a timely basis. All draw-downs of the advance should be supported by original payment documents including settlement agreements and evidence of payment.

Rating of Audit Finding - Major

Action Owner – Director CARD, in collaboration with Director CIB Underwriting, Director Relationship & Asset Management, & Director Corporate Accounting

Due Dates – All actions to be implemented by Q4 2011

6. Management of Recovery Actions

When an insurance claim is paid, the related debt is assigned to EDC for recovery purposes. During the audit we found that recovery plans are often not prepared or reviewed. As a result, we noted several instances where legal expenses were or are being incurred without consideration to such things as: the likelihood of winning the legal action, estimate of the costs associated with pursuing legal action, and the ability to recover funds in the event that the legal action is successful. We have recommended that the design of the recovery plan template be revalidated and implemented on all claims greater than a selected threshold and claims below this threshold where legal action is being contemplated. Recovery plans should be reviewed and approved by the Manager Recoveries. At a minimum, the recovery plan should address: rationale for pursuing legal action, probability of success, estimated recovery costs, rationale for continuing or discontinuing legal action once depositions have been completed, and final recovery and write-off.

Rating of Audit Finding - Major

Action Owner – Director CARD & Manager Recoveries

Due Dates – All actions to be implemented by Q2 2012

7. Monitoring Controls

We understand CRS and Debt Management (DM) include reporting features that can facilitate monitoring of core CARD activities. However, these reports are not being generated and reviewed. As a result, there is no overall monitoring of performance at a portfolio level. For example: aged open paid claims are not monitored to facilitate follow-up on recovery actions/decisions; average recoveries and expenses are not monitored; and rejected claims are not monitored to ensure consistency. We have recommended that CRS and DM reporting features be examined with the objective of leveraging reporting capabilities to facilitate effective oversight of critical claims and recoveries activities. Consistent with this recommendation, management has started to implement a performance management scorecard and review process.

Rating of Audit Finding - Major

Action Owner – Director CARD

Due Dates – All actions to be implemented by Q4 2011

8. EXPROG Claims

In 2010, 756 claims paid were under \$5,000 CAD. Collectively, these claims accounted for approximately \$1.4 MCAD of payments or 1% of total claim payments. Given the low value and high volume of these claims, CRS has been configured to perform validation checks on certain fields and automatically approve these claims for payment. This validation and automatic payment process is referred to as EXPROG. There are currently 43 filters or validation checks through which a claim must pass before it can be processed for payment by EXPROG. The large quantity of filters is causing an excessive amount of claims to be rejected by the EXPROG queue (38%). In theory, all claims rejected by EXPROG are meant to be audited prior to payment. However, given the large volume of rejections this is not always being performed and when performed it is not completed in a consistent manner. In addition, every 30th EXPROG claim and each 8th claim paid to a policyholder is meant to be audited by CARD. However, this random auditing is also not being performed consistently due to the large volume of rejected claims. We have recommended that the approach followed for processing claim payments <\$5K be reevaluated. This would include a review of the number of EXPROG filters being applied and their value-add with the objective of reducing the number of filters that do not add value. Consideration should be given to implementing a checklist for performing both random audits and audits of rejected claims to ensure consistency. Results of random audits should be tracked to determine if sampling frequency should be adjusted.

Rating of Audit Finding - Major

Action Owner – Director CARD & Manager Claims in collaboration Director Business Solutions Delivery

Due Dates – All actions to be implemented by Q1 2012

9. Practices Impacting Delegation of Authority (DOA)

During the audit we noted a number of practices that appear to be inconsistent with the intent of EDC's DOA Policy. CRS includes functionality that allows a DOA authority to pre-approve a lump sum amount for recovery expenses. This practice is known as establishing a capped expense and circumvents the intent of the DOA approval by removing oversight of expenses charged under a capped expense. It also allows the same person to record and approve an expense. CRS also includes the ability for individuals to "mask" as other individuals for the purpose of performing DOA. In most cases, masking has been implemented as a work around for the current DOA table structure which does not allow an individual to approve a transaction below their DOA level. If a policyholder files a claim related to losses incurred in two or more policy years and their policy includes a deductible, the aggregate loss is split between two or more claims. Not only are split claims laborious to administer, but they also result in DOA approvals based on the individual claim amounts instead of the aggregate value. Finally,

multiple concurrent claims submitted under one policy for different buyers are currently approved on an individual basis.

We have recommended that consideration be given to eliminating the approval of capped expenses. The DOA table structure in CRS should be adjusted to allow individuals to approve transactions from \$1 up to their assigned DOA limit with the objective of eliminating downward masking. Consideration should be given to whether split claims can be avoided by applying deductibles from two or more policy years to a single claim. Finally, we have recommended that consideration be given to approving multiple concurrent claims from a single policyholder based on the aggregate value of the claims.

Rating of Audit Finding - Major

Action Owner – Director CARD in collaboration with Director, Business Solutions Delivery

Due Dates – All actions to be implemented by Q1, 2012

10. System Limitations

CRS is not configured to receive information from Globex regarding any premiums that may be outstanding from the policyholder. Therefore, it is the Claim Services Manager's (CSM) responsibility to manually check Globex for outstanding premiums, and to deduct any outstanding premium from the claim payment. It has however, been configured to pull a number of other relevant fields including: claims admissibility date, buyer credit limit, declaration volumes, policy co-insurance ratio, and policy liability limit. However in each case, the data can be overridden in CRS by the CSM. CRS does not maintain a transaction trail of these overrides. Instead, reliance is placed on the CSM to self-declare these overrides to their manager. We also found that the design of CRS is Accounts Receivable Insurance (ARI) centric and is not well suited to support the claims and recoveries process for Contract Insurance & Bonding (CIB) products. Furthermore, there is no ability to issue net payments to policyholders which causes additional administrative costs for both EDC and its policyholders. Finally, policyholder account statements do not include transactions pertaining to the claims and recovery process and therefore are not complete statements of account.

Debt Management (DM) has not been configured to enable tracking of Trade Finance Obligations (TFO) and Political Risk Insurance (PRI) claims and recoveries activities. As a result documentation surrounding TFO and PRI claims and recoveries is maintained off line with the respective underwriting teams.

We have recommended investigating the feasibility of enhancing CRS to include/enable: a reportable transaction trail on all policy data retrieved from other systems and overrides of this information, on-line verification of premium payments prior to releasing claim payments, and the issuance of net payments to policyholders. We have also recommended that CARD transactions be included in the scope of the Cash Management Project and this has been confirmed. Finally, we have recommended that management consider the feasibility of using DM for all insurance products. In the interim, all insurance claim files should be transferred from underwriting teams and retained by CARD.

Rating of Audit Finding - Moderate

Action Owner – Director CARD in collaboration with Director, Business Solutions Delivery

Due Dates – All actions to be implemented by Q2 2012

Conclusion

The audit findings and recommendations have been communicated to and agreed by management. Some audit recommendations have already been implemented. The remaining recommendations will be implemented no later than Q2 2012.

We would like to thank management for their support throughout the audit.