

**Invoicing and Collections - Political Risk Insurance (PRI)
Final Audit Report
Report Nr. 19/10
December 6, 2010**

Distribution:

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Introduction

In accordance with our FY 2010 Audit Plan, EDC Internal Audit performed audits of the Invoicing and Collections processes at EDC including the process for Political Risk Insurance (PRI). PRI covers exporters against losses resulting from political risks, including: political violence, expropriation, and currency transfer risks. The suite of products offered by PRI includes PRI of Equity, Assets and Debt, Global Policies, and Non-Honouring Sovereign (NHS) policies. PRI premiums for the 2009 fiscal year were \$14M CAD, with volume at December 31, 2009 of \$2.6 billion.

Audit Objectives & Scope

The overall objective of the audit was to evaluate whether controls were designed and operating effectively within the PRI invoicing and collections process. This involved an assessment of what Enterprise Risk Management (ERM) risks could materialize, identifying the controls in place to mitigate these risks and performing walkthroughs and testing to evaluate their design and operating effectiveness. The audit included an examination of:

- ✓ Controls to ensure the completeness, accuracy and timeliness of invoicing, recording of receivables and collections;
- ✓ Whether existing systems and tools support the business objectives and/or are being properly leveraged to support related process objectives; and
- ✓ Mechanisms in place to measure performance and identify opportunities to continuously improve business processes for the benefit of both EDC and its customers.

Collection activities associated with insurance claim recoveries were not included in the scope of this audit. Audit fieldwork was performed from August to October 2010.

Internal Audit Opinion

In our opinion, the invoicing and collections process for the PRI program is *Well Controlled*¹. Key controls within the PRI invoicing and collections process are effectively designed and are operating as intended. Although the existing process is well controlled, there is extensive reliance on manual procedures and controls. Greater automation would be required in the event of an increase in the number of Policyholders and transactions. Moderate² areas for improvement were identified and are outlined in the following section.

Audit Findings & Recommendations

1. Alignment of MBC Functionality with PRI Business Requirements

MBC is designed to facilitate and automate portions of the Underwriting process. However, the majority of the PRI Underwriting Process is currently performed manually outside of MBC. We noted several examples where the design and functionality of MBC does not address the business requirements of the PRI program. For example:

- MBC can be configured to facilitate the pricing of transactions, having the capacity to include standard rate tables as well as incorporating non-standard pricing. Currently, however, PRI pricing

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.

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.

is performed in excel with links to the Political and Human Rights Risk Assessment (PHRAD) worksheets. As a result, there is a risk that changes to the configuration of the PHRAD worksheet may result in incorrect or broken links in the PRI pricing spreadsheet, resulting in inaccurate starting points for PRI pricing of policies.

- Currently, invoices are prepared offline via excel templates by the PRI Specialist. MBC has the capacity to utilize templates for the preparation of customer-facing documents with built-in fields that can be automatically populated. Automated templates reduce the risk of error associated with manual entry and aid in ensuring completeness of online record keeping. The use of automated invoices would also increase the efficiency of the invoicing process, as well as eliminate the need to scan a manual invoice into MBC for the purpose of record-keeping.
- During the audit, system configuration issues were identified which resulted in delays in sending policies to MTIP. This can result in delays in recording policies in MTIP and the Credit Exposure Data Mart (CEDM), as well as delays in recording AR and Revenue, which has an impact on Corporate Reporting.
- The majority of PRI policy records, including invoicing and disbursement documentation are stored on a network drive. A manual filing system such as this creates a risk for the safeguarding of key PRI policy documentation and IA is recommending that documents be stored in MBC to the extent possible.

We recommend that the functionality of MBC be reviewed against business requirements and consideration be given to addressing key gaps in future releases.

Rating of Audit Finding - Moderate

Action Owners - Director PRI in conjunction with Business Solutions Insurance

Due Date - Q2 2011

2. Segregation of Duties (SOD) and Access Controls

During this audit we found that there are some incompatible functions in the roles of underwriters, PRI Specialists and Administrators. We recommend a review and removal of SOD conflicts. Where removal is not feasible consideration should be given to implementing monitoring controls. IA notes that the BS&T access which created SOD conflicts in earlier invoicing and collections audits has now been resolved.

Rating of Audit Finding - Moderate

Action Owners - Director PRI in collaboration with Business Solutions Insurance

Due Date - Q2 2011

3. Accounting for Advance Lump Sum Payments

The average length of a PRI policy is over 7 years. Payments are due annually however, some Policyholders choose to make an advance lump sum payment at the beginning of the policy period for the full policy amount covering several years. Currently, Insurance Accounting performs a monthly journal entry to reclassify the lump sum advance payments from the short-term suspense account to the upfront premiums account. Since the policies can be cancelled, IA is recommending that an analysis be performed on the probability of policy cancellation in order to determine if treatment of advance premium payment as deferred revenue is appropriate or whether it should be treated as an "Other Credit".

Rating of Audit Finding - Moderate

Action Owner - Manager, Insurance Accounting & Canada Account in collaboration with Director, PRI

Due Date - Q2 2011

4. Administration of PRI Policies

Timely receipt of payment is important because the functionality and transaction flow within both MBC and MTIP, including the timing of the update to the Credit Exposure Data Mart, was designed based on a PRI business model where payment is received before providing insurance coverage. In order to ensure timely receipt of Policyholder payment, PRI has established a collections process. IA is recommending that this process be formalized by documenting guidance on timelines, including guidance for policy termination.

The current PRI Manual that provides guidance on underwriting and administration is dated and not available electronically. To enhance the consistency and accuracy of policy administration, PRI support

materials should be updated to reflect current underwriting and administration practices and should be reviewed and updated at least annually.

Rating of Audit Finding - Moderate

Action Owner - Director, PRI

Due Date - Q2 2011

Conclusion

The audit findings and recommendations have been communicated to and agreed by management, who has developed action plans that are scheduled for implementation no later than Q2 2011. We would like to thank management for their support throughout the audit.