

**Invoicing and Collections – Trade Finance Obligations
Final Audit Report
Report Nr. 13/10
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Introduction

In accordance with our FY 2010 Audit Plan, EDC Internal Audit performed an audit of the Invoicing and Collections process for Trade Finance Obligations (TFO). EDC's TFO product provides insurance against the failure or refusal of foreign banks or buyers to honor their payment obligations for any reason whatsoever under the terms and conditions of trade finance obligations for which EDC has issued credit approvals. Historically, credit approvals and insurance coverage have focused on the post-shipment period. However, the majority of policyholders are now also purchasing pre-shipment insurance. TFO insurance premiums are based on policyholder declarations due following shipment. In 2009, the TFO program supported \$6.0B in business volume.

Audit Objectives & Scope

The overall objective of the audit was to evaluate whether controls were designed effectively within the TFO 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 to evaluate their design effectiveness. The scope of 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 recoveries were not included in the scope of this audit. Audit fieldwork was performed from June to July 2010.

Internal Audit Opinion

In our opinion, *Opportunities Exist to Improve Controls*¹ surrounding the Invoicing and Collections process for TFO. IA found that policyholder declarations are not always processed and invoiced consistently and in accordance with TFO policy terms. As a result, we found variances between TFO policy terms and conditions and how the product is being administered in practice. These variances have emerged informally and therefore, the impact on downstream processes such as financial and business reporting has not been considered. We also found that monitoring controls are not in place to facilitate effective oversight of TFO policy administration exceptions. In some cases, implementation of effective monitoring controls is constrained by the design of FIRM. The following section provides details regarding major² and moderate audit findings.

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.

Audit Findings & Recommendations

1. Administration of Customer Policies

Customers purchasing pre-shipment and/or post shipment TFO insurance are required to submit on-line declarations using e-FIRM. TFO policy terms specify that customer declarations for pre-shipment (commitment) insurance are at the shipment date while declarations for post shipment (credit) insurance are due in the month following each shipment. In cases where a customer selects both pre and post shipment insurance, business volume for corporate performance reporting is booked when the customer submits a pre-shipment declaration. When post-shipment insurance alone is purchased, volume is booked when the customer submits the first shipment declaration.

During the audit, we found variances between TFO policy terms and conditions and how the product is being administered in practice:

- ✓ Customer declarations are often created by the Financial Institutions Team (FIT) as opposed to being completed and submitted by the customer. For example, in Q1 and Q2 2010, 168 declarations were created by FIT personnel. Collectively, these transactions represent approximately \$400 MCAD in business volume and \$2.5 MCAD in premium revenue. On-line declarations completed by customers provide evidence of an arrangement for revenue recognition purposes and provide the legal basis for collecting invoiced amounts. On-line declarations also provide support for recorded business volumes used in determining incentive payments. Therefore, it is important that declarations be consistently obtained from customers to support recorded transactions.
- ✓ Pre-shipment insurance is normally declared and payable at shipment, but is now sometimes declared and paid at the beginning of the insured period and/or periodically throughout the pre-shipment period. This practice advances the timing of when both business volume and revenue is booked. For example, in December 2009, a TFO policy was underwritten for a customer that included pre and post shipment insurance for 11 months and 1 month respectively. A declaration was created by FIT personnel at the beginning of the pre-shipment period. As a result, business volume and revenue for the pre-shipment period were booked in 2009 instead of in 2010 as per the policy terms.

These practices have emerged informally, and as a result, the impact on downstream processes such as financial reporting, business reporting, and corporate incentives has not been considered. Customer experience may also be negatively impacted by inconsistent policy administration practices. Accordingly, we recommend that the TFO product features be reviewed against how the product is being administered in practice with the objective of confirming or updating features as applicable. This review should be performed in collaboration with other stakeholders to ensure the impact of any changes on other processes is considered prior to implementing changes to the TFO product. Once completed, guidelines and controls should be developed to ensure the administration of the product is consistent with features outlined in the TFO policy.

Rating of Audit Finding – Major

Action Owners – VP, Credit Insurance Underwriting in collaboration with VP & Corporate Controller

Due Date – Q1 2011

2. Alignment of FIRM Functionality with Business Requirements

The current reporting features in FIRM make it difficult to ensure full oversight of the administration of TFO policies. Specifically:

- ✓ Changes are sometimes made by FIT to on-line declarations submitted by customers. These changes are often made based on informal requests by customers and are not always supported by customer documentation. It is important to ensure such changes are monitored and reviewed to avoid invoicing errors. However, a reportable trail of these changes is not maintained by FIRM. The transaction continues to appear as if it were last updated by the customer. As a result, it is not possible to obtain a report of all changes made by FIT to customer submitted declarations.
- ✓ FIRM has been configured to limit credits against invoiced amounts to \$50 CAD. As a result, when invoicing errors occur in excess of this amount, a record of the credit is kept off-line and the customer is instructed to apply the credit to other invoices. Invoicing errors are not material. However, such practices may negatively impact customer experience.

- ✓ A report of declarations created by FIT is not currently being generated and, as a result, there is no monitoring of this practice.

We recommend that, once the TFO product features have been confirmed and guidelines developed for processing declarations, the functionality of FIRM be reviewed against business requirements and consideration be given to addressing key reporting/feature gaps in future releases.

Rating of Audit Finding – Major

Action Owners – VP Credit Insurance Underwriting in collaboration with VP, COE & CARD and Director, Business Solutions Delivery

Due Date – Q2 2011

3. Access Controls and Segregation of Duties (SOD)

An underlying principle of effective internal controls is the need to maintain segregation between incompatible duties. For example, the ability to initiate, authorize, execute and record a transaction are incompatible duties when performed by a single individual. As part of this audit, we reviewed segregation of duties within the TFO end to end process. We found that underwriters and policy administrators have been assigned incompatible functions. For example, some FIT team members can create a customer declaration, adjust the declaration, perform collections and apply/adjust cash payments. We recommend that system access be removed to eliminate SOD conflicts. In addition, going forward, SOD should be considered prior to granting access and/or assigning responsibilities. Due to the small size of the FIT team, SOD removal may not be feasible without significant business impact. In these cases, consideration should be given to implementing monitoring controls.

Rating of Audit Finding – Major

Action Owner – VP, Credit Insurance Underwriting in collaboration with VP COE & CARD

Due Date – Q2 2011

Conclusion

The audit findings and recommendations have been communicated and agreed to 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.