

**COMPLIANCE REVIEW REPORT
for Aboriginal Affairs and Northern Development Canada
Nutrition North Canada**

**Contribution Agreement
Signed on March 30, 2011
with
Pratt's Ltd.**

**by Samson & Associates
March 31, 2012**

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1.0 Executive Summary

On April 1, 2011, the Nutrition North Canada replaced the Food Mail Program, which was operated by Canada Post since the late 60's. Much like Food Mail, the purpose of Nutrition North Canada is to make nutritious food more accessible and more affordable to residents of isolated northern communities that lack year-round surface and marine transportation links to southern centres.

Accordingly, Aboriginal Affairs and Northern Development Canada commissioned a compliance review based on specific objectives for the period covering April 1, 2011 to December 31, 2011. The results of the review are as follows:

i) Passing on the Subsidy

Review Objective: Verify that the recipient is passing on the value of the subsidy to customers, i.e. that selling prices are reduced by the amount of the subsidy.

Conclusion: The review concludes that the recipient is passing on the value of the subsidy to the purchaser of eligible NNC products, except as highlighted below.

Observation #1: The review revealed that a customer from the community of Arviat was invoiced for their freight cost even though the freight cost was collect/cash on delivery (COD). Consequently, an amount of \$29,256.38 (total freight cost of \$34,240.11 minus \$4,983.73 in NNC subsidy claimed for that order) should be reimbursed by the recipient to the customer.

Recommendation #1: The recipient should reimburse the customer from the community of Arviat for the freight that was over charged for an amount of \$29,256.38.

ii) Program Visibility

Review Objective: Verify that program visibility requirements are met (e.g. for northern retailers, that subsidy rates are written on cash receipts and program material, such as posters, are clearly visible in the store, and, for southern suppliers, that the amount of the subsidy reduction is clearly identified on customers' invoices).

Conclusion: The review revealed that the recipient was clearly identifying the subsidy reduction on customers' invoices.

iii) Claims and Reporting

Review Objective: Test the recipients' reporting and claiming systems and procedures with regards to gap and control issues, i.e. verify that the process used by the recipient to prepare detailed reports and calculate the amount of subsidy to be claimed is sound and precise, and that mechanisms to detect and correct errors are in place.

Conclusion: The review of the reporting and claiming systems and related procedures revealed that the controls were adequate to ensure the subsidy being claimed is precise and that mechanisms to detect and correct errors were in place, except as highlighted below.

Observation #2: The review revealed that the recipient's claim reports do not include the invoice number and the waybill number as required by NNC. These details should be presented in the recipient's claim reports.

Recommendation #2: We recommend that the recipient include the invoice number and the waybill number in their claims report as required by NNC.

iv) Respect of Program Rules

Review Objective: Verify that recipients respect all program rules, especially in regards to sales to ineligible customers such as mining camps or construction companies.

Conclusion: The review revealed that the recipient was respecting the program rules with respect to sales to ineligible customers.

2.0 Introduction

2.1 Background

On April 1, 2011, Nutrition North Canada (NNC) replaced the Food Mail Program, which was operated by Canada Post since the late 60's. Much like Food Mail, the purpose of NNC is to make nutritious food more accessible and more affordable to residents of isolated northern communities that lack year-round surface and marine transportation links to southern centres.

There are currently 103 communities eligible for the program (82 are eligible for a full subsidy and 21 for a partial subsidy), located in Nunavut, the Northwest Territories, Yukon, Labrador, Quebec, Ontario, Manitoba and Saskatchewan. Two levels of subsidy rates per kilogram have been established for each community; Level 1 (higher) for the most nutritious perishable foods and Level 2 (lower) for other eligible items. Communities where operating and transportation costs are higher (e.g. Grise Fiord, NU) tend to have higher subsidy rates.

Northern retailers and southern suppliers registered with the program (the recipients) are responsible to manage their supply chain and claim the subsidy from NNC for eligible food and non-food items that they ship by air to eligible communities. On a monthly basis, they must submit a claim form (kg x subsidy rates), a detailed shipment report (kg per item, community, consumer type, etc.), invoices and waybills to receive the payment (most receive advance payments based on forecasted weights). These documents are submitted to the program's claims processor under contract with Aboriginal Affairs and Northern Development Canada (AANDC) (the Saskatchewan Institute of Information Technology in collaboration with Crawford). The claims processor verifies the claims and provides NNC with a recommendation for payment. Registered northern retailers must also submit, directly to NNC, a monthly pricing report for a pre-determined list of food items. These and other program requirements are identified in contribution agreements between the recipients and AANDC.

As of December 31, 2011, seven northern retailers and 26 southern suppliers were registered with NNC. Northern retailers are those entities that operate food retail one or multiple stores in eligible communities. Southern suppliers are food providers operating out of non-NNC eligible communities that supply eligible items directly to small northern retailers, commercial establishments (restaurants, etc.), social institutions (daycares, etc.) and individuals (referred to as direct or personal orders) located in eligible communities.

The selection of recipients for this compliance review was based on perceived risk and geographical location. Risk levels for compliance review purposes were based on the current experience with recipients regarding the claiming and reporting process, i.e. difficulties encountered by the claims processor, on information brought to the program's attention by interested parties, and on materiality. For practicality and cost-effectiveness reasons, at least two recipients have been selected per geographical location.

2.2 Objectives

The objective of the recipient compliance review is to provide assurance that the NNC recipient is in compliance with the terms and conditions of the funding agreements signed with AANDC. Specifically, the compliance review will:

1. Verify that recipients are passing on the value of the subsidy to customers, i.e. that selling prices are reduced by the amount of the subsidy;
2. Verify that program visibility requirements are met (e.g. for northern retailers, that subsidy rates are written on cash receipts and program material, such as posters, are clearly visible in the store, and, for southern suppliers, that the amount of the subsidy reduction is clearly identified on customers' invoices);
3. Test the recipients' reporting and claiming systems and procedures with regards to gap and control issues, i.e. verify that the process used by recipients to prepare detailed reports and calculate the amount of subsidy to be claimed is sound and precise, and that mechanisms to find errors and fix them are in place; and
4. Verify that recipients respect all program rules, especially with respect to sales to ineligible customers such as mining camps or construction companies.

2.3 Scope

The scope included the funding provided by AANDC to Pratt's Ltd. for the period April 1, 2011 to December 31, 2011. The review was conducted in the recipient's offices in Winnipeg, Manitoba, from March 20 to 23, 2012.

2.4 Approach and Methodology

The compliance review included the examination of the following:

- The pricing/invoicing practices in relation to the subsidy, e.g. profit margins on subsidized products vs. unsubsidized products;
- The weighing and shipping process;
- The sale and/or purchasing records and supporting documentation to verify compliance with program rules;
- The reporting and claiming systems and procedures, to determine how the recipient:
 - ensures that only eligible items are claimed for and reported;
 - calculates the appropriate weight of items being claimed;
 - makes monthly claims and detailed reports that are valid and accurate; and
 - ensures controls are in place to find errors and fix them on a timely basis.

Furthermore, the review included the conduct of interviews with the recipient and with NNC staff and the claims processor. The sampling approach and appropriate coverage were determined during the planning phase of the review.

2.5 Conclusion

With the exception of the observations and recommendations presented in Section 3.1 and Section 3.3, in our view, the recipient has complied with the objectives of the review.

3.0 Compliance with the Objectives

3.1 Passing on the Subsidy

Review Objective: Verify that the recipient is passing on the value of the subsidy to customers, i.e. that selling prices are reduced by the amount of the subsidy.

Conclusion: The review concludes that the recipient is passing on the value of the subsidy to customers for purchases of eligible products, except as highlighted below.

Observation #1: The review revealed that a customer in the community of Arviat was invoiced for their freight cost even though the freight cost was collect/cash on delivery (COD). Consequently, an amount of \$29,256.38 (total freight cost of \$34,240.11 minus \$4,983.73 in NNC subsidy claimed for that order) should be reimbursed by the recipient to the customer.

Recommendation #1: The recipient should reimburse the customer in Arviat for the freight that was over charged for an amount of \$29,256.38.

Observation Note: The customer completes his shopping list (order) using the recipient's catalog and forwards it by fax or email to the recipient. The order specifies the item catalog number and quantity. The recipient then enters this information into their purchasing/accounting system (in-house software) which generates a pick list. The pick list is used to complete the order. Once the order is complete, it is verified and an invoice is generated which contains the item catalog number, the quantity, the amount, the weight, the NNC subsidy and the freight cost. (The weight used to calculate the value of the subsidy is the weight obtained from the supplier). However, for the Arviat community, the freight cost is paid COD and should not have been included on the invoice. Consequently, this resulted in the observation identified above.

3.2 Program Visibility

Review Objective: Verify that program visibility requirements are met (e.g. for northern retailers, that subsidy rates are written on cash receipts and program material, such as posters, are clearly visible in the store, and, for southern suppliers, that the amount of the subsidy reduction is clearly identified on customers' invoices).

Conclusion: The review revealed that the recipient was clearly identifying the subsidy reduction on customers' invoices.

3.3 Claims and Reporting

Review Objective: Test the recipients' reporting and claiming systems and procedures with regards to gap and control issues, i.e. verify that the process used by recipients to prepare detailed reports and calculate the amount of subsidy to be claimed is sound and precise, and that mechanisms to detect and correct errors are in place.

We tested the recipient's reporting and claiming procedure by selecting a random number of transactions from the total claims produced from April 1, 2011 to December 31, 2011 by using statistical sampling techniques.

Conclusion: The review of the reporting and claiming systems and related procedures revealed that the controls were adequate to ensure the subsidy being claimed is precise and that mechanisms to detect and correct errors were in place, except as highlighted below.

Observation #2: The review revealed that the recipient's claim reports do not include the invoice number and the waybill number as required by NNC. These details should be presented in the recipient's claim reports.

Recommendation #2: We recommend that the recipient include the invoice number and the waybill number in their claims report as required by NNC.

3.4 Respect of Program Rules

Review Objective: Verify that recipients respect all program rules, especially in regards to sales to ineligible customers such as mining camps or construction companies.

Conclusion: The review revealed that the recipient was respecting the program rules with respect to sales to ineligible customers.

APPENDIX A - Recipient's Comments to the Draft Report and the Auditor's Response

Observation #1: The review revealed that a customer in the community of Arviat was invoiced for their freight cost even though the freight cost was COD. Consequently, an amount of \$29,256.38 (total freight cost of \$34,240.11 minus \$4,983.73 in NNC subsidy claimed for that order) should be reimbursed by the recipient to the customer.

Recipient's Comment:

This was an administrative error for which the client was fully reimbursed as soon as it was discovered by the auditor.

Auditor's response:

No response required.

Observation #2:

The review revealed that the recipient's claim reports do not include the invoice number and the waybill number as required by NNC. These details should be presented in the recipient's claim reports.

Recipient's Comment:

The company's informatics system has been customized to meet this requirement so invoice and waybill numbers are now reflected on detailed shipment reports. We have been told by the program's claims processor that the updated report fully meet the claims verification needs.

Auditor's response:

No response required.