

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

**Contribution Agreement  
Signed on March 25, 2011  
with  
North West Company LP operating as Valu Lots**

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

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## 1.0 Executive Summary

On April 1, 2011, Nutrition North Canada replaced the Food Mail Program, which had been 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 link 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 revealed that we were unable to ascertain whether the recipient was passing on the value of the subsidy to the customer for orders taken via a Web application and for in-store purchases.

**Observation #1:** The review revealed that for orders taken through the Web and in-store, the value of the NNC subsidy in dollars is neither visible on the order nor on the invoice to the customer. The recipient has indicated that the subsidy is already deducted from each individual item's price on the order and invoice and therefore, there is no indication of total amount or individual amount of the NNC subsidy on the customer's order or invoice. Consequently, we were unable to ascertain whether the weight being claimed for the NNC subsidy was accurately passed on to the customer for orders taken through the Web and in-store, which represents 52% of the total weight claimed by the recipient for the review period.

**Recommendation #1:** We recommend that the recipient review its procedures and processes to ensure there is an appropriate audit trail that would enable the auditors to ascertain whether the NNC subsidy was accurately passed on to the customer. The amount of subsidy should be indicated on the invoices.

**Observation #2:** The review revealed that the recipient was using two distinct data sources for the weight of the products it sells. One data source was used for the production of the customer's invoice and the other data source was used for the preparation of the NNC claim. The review further revealed that there was no reconciliation between the two data sources and consequently, we could not ascertain whether the total amount of the NNC subsidy passed on to the customer reconciled with the total amount of the NNC subsidy claimed from NNC.

**Recommendation #2:** We recommend that the recipient ensure that both data sources be reconciled to ensure that the amount of subsidy passed on to customers equals the amount claimed.

**Observation #3:** The recipient made some modifications to the presentation of customer invoices at the beginning of October 2011 which resulted in order calculation errors of the Level 2 subsidy for phone orders. (Note: there were no errors found in relation to other methods used for orders, such as Web or in-store). Consequently, the Level 2 subsidy from October 2011 to the present, for orders taken by phone, was not passed on to customers and this resulted in \$1,016.59 being claimed in excess of the amount passed on to customers. The recipient has indicated that they will correct these calculation errors in the invoicing system.

**Recommendation #3.1:** We recommend that the recipient take the necessary actions to ensure that customers receive the appropriate NNC subsidy to which they are entitled based on their purchases.

**Recommendation #3.2:** We recommend that the recipient provide the amount of the NNC subsidy that was claimed but not passed on to customers, for orders taken by phone, from January 1, 2012 until such time as the calculation errors in the customers' billing are corrected.

#### 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 not identifying the subsidy reduction on customers' invoices for orders taken via a Web application and for in-store purchases.

Refer to Observation and Recommendation #1.

#### iii) Claims and Reporting

**Review Objective:** Test the recipients' reporting and claiming systems and procedures with regard 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 not adequate to ensure that the amount of subsidy being claimed was precise and that mechanisms to detect and correct errors were in place.

Refer to Observation #3 and Recommendation #3.1 and Recommendation #3.2.

#### iv) Respect of Program Rules

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

**Conclusion:** The review revealed that the recipient respected the program rules regarding sales to ineligible customers.

## **2.0 Introduction**

### **2.1 Background**

On April 1, 2011, Nutrition North Canada (NNC) replaced the Food Mail Program, which had been 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, Nunavut) tend to have higher subsidy rates.

Northern retailers and southern suppliers registered with the program (the recipients) are responsible for managing their supply chain and then claim a 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 who is 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 the 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 under 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 (e.g. restaurants), social institutions (e.g. daycares) 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 the recipient is passing on the value of the subsidy to consumers, 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 detect and correct errors 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 Valu Lots for the period April 1, 2011 to December 31, 2011. The review was conducted in the offices of Valu Lots in Winnipeg, Manitoba, from March 12 to 15, 2012.

## **2.4 Approach and Methodology**

The compliance review included 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 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**

In our opinion, the recipient has not 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 revealed that we were unable to ascertain whether the recipient was passing on the value of the subsidy to the customer for orders taken via a Web application and for in-store purchases.

**Observation #1:** The review revealed that for orders taken through the Web and in-store, the value of the NNC subsidy in dollars is neither visible on the order nor on the invoice to the customer. The recipient has indicated that the subsidy is already deducted from each individual item's price on the order and invoice and therefore, there is no indication of total amount or individual amount of the NNC subsidy on the customer's order or invoice. Consequently, we were unable to ascertain whether the weight being claimed for the NNC subsidy was accurately passed on to the customer for orders taken through the Web and in-store, which represents 52% of the total weight claimed by the recipient for the review period.

**Recommendation #1:** We recommend that the recipient review its procedures and processes to ensure there is an appropriate audit trail that would enable the auditors to ascertain whether the NNC subsidy was accurately passed on to the customer. The amount of subsidy should be indicated on customers' invoices.

**Observation Note:** For the period under review, the recipient received orders from customers in three ways: phone/fax, Internet (via a Web application) and in-store.

**Phone/Fax:** This method for taking orders was available from April to December 2011. Once the order was taken, it was entered in a spreadsheet using the MS Excel application. The application calculated and generated an order form which included the NNC subsidy, the weight, freight cost and the total cost to the customer. The formulas and information to calculate the subsidy by community and the weight of items ordered form part of the Excel spreadsheet. (The item weight used in the spreadsheet to calculate the value of the NNC subsidy is the weight of the item which was taken manually by Valu Lots employees).

**Internet:** The Web application was available from April to September 2011 but was inactive for June and July. This method for placing an order stopped being used in October 2011. During the period of operation, the customer would place an order through a Web application. The application would calculate and generate an order form which indicated the quantity, the item weight, the item, the shipping cost and the total order cost. The value of the NNC subsidy was not indicated on the order form but, as per the recipient, it was deducted from the shipping cost. We were able to confirm that the shipping cost did contain a rebate given that the actual shipping cost paid by the recipient was greater than the shipping cost charged to the customer and listed on the order form. However, we were unable to assess whether the rebate amount corresponded

to the amount of NNC subsidy to which the customer was entitled based on the contents of the order. Consequently, we can state that a rebate was passed on to the customer however, we cannot provide an opinion on whether the rebate was equivalent to the value of the NNC subsidy to which the customer was entitled based on the items ordered.

***In-Store:*** A customer comes into the store with a purchase order (PO). The POs are given to the person by the welfare administrator from their First Nations community. The PO will instruct Valu Lots how much the customer is allowed to shop. The customer goes through the store and picks up all their items. These items are then brought to the NNC cash register in Valu Lots' back room. The items are all rung through the cash register. At the register, there are posters that show the NNC subsidy amounts for each community for the customer to see. In the North West Company (NWC) stores, these rates are posted on the receipts but in Valu Lots they have a poster to show each customer. After the groceries are all rung through the cash register, they are weighed to get the total weights (in lbs) for the airlines. Valu Lots has determined that the average cost for freight to be charged is 45% of the total weight. The amount of the freight is then rung into the cash register under a freight account and this is added to the total amount of the groceries. The cash receipt does not indicate the amount of the NNC subsidy. The receipt is sent to that customer's First Nations welfare administrator for payment. The First Nation issues a cheque monthly for the total of all their POs to the NWC head office.

***Observation #2:*** The review revealed that the recipient was using two distinct data sources for the weight of the products it sells. One data source was used for the production of the customer's invoice and the other data source was used for the preparation of the NNC claim. The review further revealed that there was no reconciliation between the two data sources and consequently, we could not ascertain whether the total amount of the NNC subsidy passed on to the customer reconciled with the total amount of the NNC subsidy claimed from NNC.

***Recommendation #2:*** We recommend that the recipient ensure that both data sources be reconciled to ensure that the amount of subsidy passed on to customers equals the amount claimed.

***Observation #3:*** The recipient made some modifications to the presentation of customer invoices at the beginning of October 2011 which resulted in order calculation errors of the Level 2 subsidy for phone orders. (Note: there were no errors found in relation to other methods used for orders, such as Web or in-store). Consequently, the Level 2 subsidy from October 2011 to the present, for orders taken by phone, was not passed on to customers and this resulted in \$1,016.59 being claimed in excess of the amount passed on to customers. The recipient has indicated that they will correct these calculation errors in the invoicing system.

***Recommendation #3.1:*** We recommend that the recipient take the necessary actions to ensure that customers receive the appropriate NNC subsidy to which they are entitled based on their purchases.

***Recommendation #3.2:*** We recommend that the recipient provide the amount of the NNC subsidy that was claimed but not passed on to customers for orders taken by phone, from January

1, 2012 until such time as the calculation errors in the customers' billing are corrected.

### **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 not identifying the subsidy reduction on customers' invoices for orders taken via a Web application and for in-store purchases.

Refer to Observation and Recommendation #1.

### **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.

**Conclusion:** The review of the reporting and claiming systems and related procedures revealed that the controls were not adequate to ensure that the amount of subsidy being claimed was precise and that mechanisms to detect and correct errors were in place.

Refer to Observation #3 and Recommendations #3.1 and 3.2.

### **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 respected the program rules regarding sales to ineligible customers.

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

### ***Observation #1:***

The review revealed that for orders taken through the Web and In-Store, the value of the NNC subsidy in dollars is neither visible on the order nor on the invoice to the customer. The recipient has indicated that the subsidy is already deducted from each individual item's price on the order and invoice and therefore, there is no indication of total amount or individual amount of the NNC subsidy on the customer's order or invoice. Consequently, we were unable to ascertain whether the weight being claimed for the NNC subsidy was accurately passed on to the customer for orders taken through the Web and in-store, which represents 52% of the total weight claimed by the recipient for the review period.

### **Recipient's Comment:**

The Web system was the system we used with the older Food Mail system. In May, 2011 we stopped using the Web system and started using an ordering spreadsheet. However, in October 2011, the order spreadsheet became unusable so we went back to using the Web system for one month. During this time, we developed a new ordering spreadsheet which is the one we currently have today. Other than the 3 months in 2011 that we used the Web system, we have not used it nor will we do so in the future.

### **Auditor's response:**

No response required.

### **Recipient's Comment:**

With our current ordering spreadsheet, we have a process in place, which shows the NNC savings on every order and tells the customer how much money they saved through NNC. This is the same amount that we claim to NNC each month.

### **Auditor's response:**

No response required.

### ***Observation #2:***

The review revealed that the recipient was using two distinct data sources for the weight of the products it sells. One data source was used for the production of the customer's invoice and the other data source was used for the preparation of the NNC claim. The review further revealed that there was no reconciliation between the two data sources and consequently, we could not ascertain whether the total amount of the NNC subsidy passed on to the customer reconciled with the total amount of the NNC subsidy claimed from NNC.

**Recipient's Comment:**

We have reconciled the weights so that both systems are the same. We will complete a monthly audit to ensure the 2 systems stay the same.

**Auditor's response:**

The recipient should ascertain that, for the period of April 1, 2011 to present, the total amount of the NNC subsidy passed on to customers reconciles with the total amount of the subsidy that was claimed from NNC.

**Program's response:**

After investigation, it was determined that the amount of subsidy the recipient claimed from NNC was lower than the amount of reduction passed on to its clients. Valu Lots did not claim the difference from the program.

**Observation #3:**

The recipient made some modifications to the presentation of the customer invoices at the beginning of October 2011 which resulted in order calculation errors of the Level 2 subsidy for phone orders. (Note: there were no errors found in relation to other methods used for orders, such as Web or in-store). Consequently, the Level 2 subsidy from October 2011 to the present, for orders taken by phone, was not passed on to customers and this resulted in \$1,016.59 being claimed in excess of the amount passed on to customers. The recipient has indicated that they will correct these calculation errors in the invoicing system.

**Recipient's Comment:**

This calculation error has been corrected and password protected into our spreadsheet.

**Auditor's response:**

The recipient should indicate if they will reimburse their customers or NNC.

**Recommendation #3.1:**

We recommend that the recipient take the necessary actions to ensure that customers receive the appropriate NNC subsidy to which they are entitled based on their purchases.

**Recipient's Comment:**

The calculation error was corrected on December 22, 2011. All these Level 2 NNC rebates have been passed on since December 22, 2011. Therefore, there are no errors in 2012.

**Auditor's response:**

No response required.

**Program's response:**

Valu Lots reimbursed the amount of \$1,016.59 to NNC. This amount was deducted from a subsequent payment due to the recipient.