

**Corporate Portfolio Management  
Contract Insurance and Bonding  
Final Audit Report  
Report Nr. 07/10  
March 30, 2010**

**Distribution:**

**To:** President & CEO  
Senior Vice President & Chief Financial Officer  
Senior Vice President, Insurance  
Vice President & Corporate Controller  
Director, CIB Underwriting  
Senior Underwriter, CIB Underwriting

**CC:** Senior Vice President, Legal Services & Secretary  
Senior Vice President, Human Resources  
Senior Vice President, Business Development  
Senior Vice President, Financing Products Group  
Senior Vice President, Business Solutions & Technology  
Vice President & Chief Risk Officer  
Vice President, Portfolio Management  
Vice President & CIO  
Director, Enterprise Architecture  
Director, Asset Management  
Vice President, Strategic Planning & Corporate Communications  
Director, Planning & Government Relations  
Principal, Office of the Auditor General  
Director, Office of the Auditor General

**Audit Team:**  
A. Lowe  
J. Rosenbaum  
E. Tarsky-Abrams

**Vice President, Internal Audit**  
M. Ryan

## Introduction

In accordance with our audit plan, EDC Internal Audit performed an audit of Corporate Portfolio Management for Contract Insurance and Bonding (CIB). Corporate Portfolio Management is the planned and continuous, ongoing monitoring activities done to identify changes in credit risk post origination. It includes the mitigation strategies and tools used to manage these exposures and the measurement and reporting of these exposures to management and the Board. The Credit Monitoring and Review Policy establishes the standards for monitoring EDC's portfolio of credit commitments within the Financing Group and Insurance Group programs, and describes the process for assessing changes in credit risk. The policy has the goal of ensuring that EDC's credit commitments are monitored appropriately, and if post-commitment actions may be required, to outline decision making and reporting responsibility for such actions. EDC's corporate portfolio of credit exposure includes contract insurance and bonding, credit insurance, loans, and trade finance obligations.

## Audit Objectives & Scope

This report contains the findings for the audit of the CIB component of EDC's portfolio. The design of the monitoring process for CIB obligors is currently being finalized with a planned implementation date of Q2 2010. Accordingly, the objective of this audit was to review the design of the controls as planned for changes in credit risk post-origination, credit risk measurement at the portfolio level, and credit risk mitigation activities (e.g. reinsurance, hedging, etc.).

The audit addressed the following risk elements of EDC's Enterprise Risk Management (ERM) framework: insurance, transaction processing, governance, compliance, portfolio concentration & capital allocation, reputation, fraud and ethical, change management/alignment and knowledge capital.

Audit fieldwork was performed from January to March 2010.

## Internal Audit Opinion

In our opinion, the design effectiveness of the Corporate Portfolio Management process for the contract insurance and bonding portfolio is **Well Controlled**<sup>1</sup>. The audit was performed prior to the launch of the CIB monitoring program. A strong commitment was made by management to address control issues as they were identified. As a result, no major<sup>2</sup> audit findings exist. Moderate control deficiencies were noted and are described in the following section.

---

<sup>1</sup> 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.

<sup>2</sup> Our audit findings are ranked 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. Identification of Obligors for Monitoring & Development of Monitoring Plan

Embedded in the current process design is the use of a C3 report of all won CIB opportunities to identify all obligors that require monitoring. The report will also be used to assign all obligors to risk analysts. Controls have not yet been designed to ensure all obligors are monitored in accordance with objectives regarding the type and frequency of monitoring activities. Accordingly, we recommend that a monitoring plan be created based on the C3 report and updated quarterly for new obligors. The plan should include the assigned risk analyst, the most recent obligor risk rating, monitoring frequency, level of monitoring required and completion date of review. Actual coverage against this plan should be monitored quarterly and monitoring activities prioritized as required.

Rating of Audit Finding - Moderate  
Action Owner - Senior Underwriter, CIB Underwriting  
Due Date - Q2 2010

### 2. Information Used for Monitoring

The current process design includes a combination of on-going and periodic monitoring activities. On-going monitoring activities will be facilitated largely by information received through external subscription services such as Capital IQ and Dun & Bradstreet. Information submitted on a quarterly basis by each obligor together with discussions with obligor management will be used to perform periodic monitoring activities. We recommend that external subscription services be configured such that the information risk analysts receive is limited to their portfolio. In addition for common obligors, a process should be established with the Risk Management Office (RMO) and Risk Assessment and Portfolio Management (RAPM) to share monitoring information. The feasibility of coordinating monitoring activities with RMO and RAPM to avoid duplication should also be examined. Finally, we noted that thresholds for suspending facilities in situations where the required information is not submitted by the obligor are lenient and should be reconsidered.

Rating of Audit Finding - Moderate  
Action Owner - Senior Underwriter, CIB Underwriting  
Due Date - Q2 2010

### 3. Monitoring Activities

Under the current process design, the CIB Monitoring Team would be responsible for performing on-going and quarterly monitoring activities, while CIB underwriters would perform annual monitoring activities. All monitoring reports and supporting material will be posted in C3. A monitoring guide is currently being developed and will outline roles and responsibilities, detailed procedures to be followed and actions to be taken based on monitoring results. We recommend that C3 not be used to store monitoring reports and supporting material until the associated risks have been reviewed with Legal Services. Using C3 as a monitoring system has and will continue to require system changes which may increase the complexity and costs of subsequent vendor upgrades. We recommend that an analysis be done to examine the feasibility of leveraging the RMO's monitoring system (AMA) before investing in additional changes to C3. We also recommend that the CIB Monitoring Team lead all monitoring activities and consult with CIB underwriters as appropriate.

Rating of Audit Finding - Moderate  
Action Owner - Director, CIB Underwriting  
Due Date - Q2 2010

#### 4. Risk Mitigation Actions

Under the current process design, actions will only be taken to mitigate risk based on the results of annual monitoring activities. Any disagreements between the monitoring team and underwriters regarding the action to be taken will be escalated to and resolved by the Director Underwriting. When appropriate, the obligor's risk rating will be updated in MBC and the facility limit adjusted. We recommend that daily and quarterly monitoring activities also be used to update obligor risk ratings and facility limits. We recommend that clear criteria be established for adjusting risk ratings and facilities based on monitoring results in order to minimize any disagreements. The proposed escalation process for resolving disagreements between the CIB Monitoring Team and CIB underwriters should be reconsidered to ensure proper segregation of duties. Finally, a process needs to be established to ensure that the MBC risk rating and facility limit is changed on a timely basis. RMO will need to be notified of all changes to MBC risk ratings in order that the Company Index and Corporate Exposure Data Mart can be updated as required.

Rating of Audit Finding - Moderate

Action Owner - Director, CIB Underwriting & Senior Underwriter, CIB Underwriting

Due Date - Q3 2010

#### 5. Loss Analysis

The scope of the current process design does not include loss analysis activities to assess the decision process at origination, and also the adequacy of obligor surveillance and risk mitigation activities to ensure that credit deterioration was detected in a reasonable time frame and that subsequent actions were appropriate. Conducting such an analysis would be helpful in identifying opportunities to improve processes. Accordingly we recommend that procedures be developed to conduct loss analysis.

Rating of Audit Finding - Moderate

Action Owner - Senior Underwriter, CIB Underwriting

Due Date - Q3 2010

### 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 Q3 2010.

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