

**Corporate Portfolio Management – Commercial Loans**  
**Final Audit Report**  
**Report Nr. 05/11**  
**June 29, 2011**

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## Introduction

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As per our FY2011 Audit Plan, EDC Internal Audit performed an audit of the operating effectiveness of controls in the Corporate Portfolio Management process for commercial loans. Corporate Portfolio Management is the ongoing monitoring performed by EDC to identify changes in credit risk post origination. It includes on-going communication with obligors and approval of commercial loan modifications. It also 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. It 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.

## Audit Objectives & Scope

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The objective of this audit was to evaluate whether the controls in the Corporate Portfolio Management process for the commercial loans portfolio are operating as intended. The scope of this audit included testing of the controls in the following areas:

- monitoring and documentation of obligor reviews,
- processing and documentation of post-origination changes to commercial loans (i.e. waivers, amendments and consents),
- monitoring of financial covenants,
- execution of credit portfolio management activities to sell, re-insure, hedge, or diversify credit risk, and
- aggregation of commercial loans exposures and reporting to management and the Board,
- access to, and use of the Asset Management Automation tool (AMA) for documentation and approval of obligor reviews and other post-origination changes to commercial loans.

## Internal Audit Opinion

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In our opinion the Corporate Portfolio Management process for commercial loans portfolio is *Well Controlled*<sup>1</sup>. We found that key controls around monitoring and documenting obligor reviews, processing and documentation of post-origination changes to commercial loans (i.e. waivers, amendments and consents), monitoring financial covenants, execution of credit portfolio management activities, and commercial loans reporting to management and the Board were operating as intended. Some moderate<sup>2</sup> issues were noted and are described in the following section.

## Audit Findings & Recommendations

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### Obligor Monitoring Procedures

Prior to the implementation of AMA, Asset Management manually tracked the completion of obligor reviews. With the implementation of AMA, the tracking of obligor reviews was automated and an aging report was created to monitor the completion of obligor reviews. No formal procedures were developed on implementation to ensure that review dates were initially scheduled in AMA for all new and existing obligors. As result, not all obligor reviews were completed and tracked on the aging report. In addition, the aging report extracted from AMA does not clearly indicate whether the obligor review has been completed making it difficult to monitor aging of obligor reviews. We recommend that Asset Management develop procedures to ensure that all obligor reviews are accurately scheduled in AMA. We also recommend that Asset Management perform a review of the AMA aging report used to monitor the completion of obligor reviews to ensure that accurate data is being used to compile the report.

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<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.

Obligor reviews are currently performed for all obligors with exposure greater than \$10M with the objective of mitigating future potential losses for EDC. For obligors with exposure less than \$10M, an Asset Manager is assigned to each file for follow-up on risk related issues as they arise, and to ensure on-going monitoring of compliance with covenants. While oversight of these obligors exists, formal annual credit reviews are not performed for this group of obligors. The aggregate exposure for this group of obligors exceeds \$1.6B. It is unclear whether formal obligor reviews are the appropriate technique to review this group of obligors. For example, this group consists partly of Small Business Financing customers who are generally not required to submit periodic financial statements that would enable EDC to perform a financial review. As result, a formal review would not be feasible, and due to the nature of the product would not result in decreased risk for EDC. We recommend that an analysis be performed of obligors with exposure less than \$10M CAD to determine the appropriate method and level of monitoring.

Rating of Audit Finding - Moderate  
Action Owner – Director, Asset Management  
Due Dates – Q4 2011

## **Waivers, Amendments & Consents**

Asset Management prepares and approves waivers, amendments and consents (WAC's) for commercial obligors as part of their on-going activities. According to Asset Management's procedures manual, once WAC's are completed and approved, they are sent to the Loans Services team to ensure that the loans subledger reflects the most current loan information. During our testing, we noted that not all WAC's were received by Loans Services. This creates a risk that a WAC impacting the loans subledger will not be sent to Loans Services resulting in inaccurate loan information. With the recent implementation of AMA, Asset Management has the opportunity to leverage the new tool to streamline the WAC process. As result, we recommend that Asset Management investigate whether AMA can generate an automatic alert to Loans Services whenever a WAC is completed and approved.

Rating of Audit Finding - Moderate  
Action Owner – Director, Asset Management  
Due Dates – Q4 2011

## **Conclusion**

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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 Q4 2011.

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

