



**Corporate Portfolio Management
Consolidated Audit Report
Report Nr. 09/10
June 30, 2010**

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Introduction

In accordance with our 2009 & 2010 Audit Plans, EDC Internal Audit (IA) performed four Portfolio Management audits relating to Accounts Receivable Insurance (ARI), Documentary Credits Insurance (DCI), Commercial Loans, and Contract & Insurance Bonding (CIB). 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.

Individual audit reports including detailed findings and recommendations were issued for each of the four audits. The purpose of this report is to summarize our findings by portfolio management audit and provide an overall opinion on EDC's Corporate Portfolio Management Process.

Audit Objective & Scope

The objective of each portfolio management audit was to evaluate the design effectiveness of the controls in place to monitor credit exposures post origination and mitigate credit risk based on the results of monitoring activities. At the time of our audit, many of the monitoring and risk mitigation activities for CIB had been designed but were not yet fully operational. As a result, our assessment of the design effectiveness of CIB portfolio management controls did not always include reviewing an example of the control being performed.

In phase II of the audits, we will be evaluating the operating effectiveness of these controls by conducting detailed testing to conclude whether the controls are operating and functioning continuously, as intended.

Internal Audit Opinion

In our opinion, EDC's Corporate Portfolio Management process is **Well Controlled**¹. Effective monitoring and risk mitigation controls have been designed. Some moderate² and minor areas for improvement were identified and are highlighted in the following section. In addition, the Credit Risk Rating Engine and Asset Management Automation (AMA) projects will further enhance the effectiveness of EDC's Corporate Portfolio Management. Although the initial AMA implementation will support RMO monitoring activities only, consideration is being given to using AMA to also support CIB monitoring activities.

¹ Our standard audit opinions are as follows:

- **Strong Controls:** Key controls are effectively designed and/or 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/or 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 and/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 and/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 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.

Basis for Overall Audit Opinion

Through the completion of these four audits, we have examined portfolio management controls for 100% of EDC's short term credit exposure (ARI & DCI) and 78% of EDC's medium and long term credit exposure (CIB & commercial loans & guarantees). This level of audit coverage is sufficient to support an overall opinion on the design effectiveness of the controls surrounding EDC's Corporate Portfolio Management process. Additional details are provided in Table 1 below.

Table 1 - Audit Coverage

Credit Exposure Type	Q1 2010	Audit Coverage
Total Notional Medium & Long Term Credit Exposure (CIB, PRI, Equity, Commercial & Sovereign Loans and Guarantees)	59.377 BCAD	78%
Total Estimated Short Term Credit Exposure (Banks & Buyers)	10.181 BCAD	100%

Consolidated Audit Findings & Recommendations

Through the completion of the four portfolio management audits we have identified eight key portfolio management activities. Table 2 provides a summary of our audit findings by activity and product line:

- Green - key controls relating to this activity are effectively designed; and
- Yellow - moderate/minor areas for improvement were identified for the activity.

It should be noted that more areas for improvement were noted for CIB simply because obligor monitoring was a new activity for this product line and had not been fully implemented at the time of our audit.

Table 2 - Audit Results by Product

Key Portfolio Management Activities	Portfolio Management Process			
	Loans	CIB	ARI	DCI
1. Guidelines have been established and communicated outlining how and the frequency with which formal obligor credit reviews should be performed.		(1)		
2. Monitoring personnel review information from external sources on an on-going basis as a means of identifying changes that may impact obligor credit risks. Formal obligor credit reviews may be initiated as a result of information collected from external sources.				
3. A process exists to ensure formal obligor credit reviews are performed on a periodic basis and that collectively these reviews provide sufficient coverage of credit exposure at a portfolio level.		(2)		
4. Obligor credit reviews are approved and timely actions are taken when appropriate to mitigate credit exposures based on the results of monitoring activities.		(3)		
5. Risk transfer is used to mitigate credit exposures.		N.A.	(4)	N.A.
6. Information impacting obligor credit worthiness is shared across monitoring teams.		(5)		
7. Claims are analyzed in order to identify opportunities to improve monitoring and/or risk mitigation activities.	N.A.	(6)		(6)
8. Credit exposure reporting facilitates oversight of corporate credit risk by country, sector and obligor.			(7)	(7)

Table Notes:

- (1) Updates to the CIB monitoring guide are being made to clarify that parentage structure must be considered when determining which obligor entity in a related family should be the focus of monitoring activities. Furthermore, once completed the monitoring guide will be reviewed with RMO to ensure methodologies are harmonized to the extent possible. Any significant future changes will also be vetted with RMO.
- (2) Efforts are underway to develop an annual monitoring plan outlining the frequency and level of monitoring to be completed for each CIB obligor. The monitoring plan will be updated quarterly for won opportunities and assignments to risk analysts adjusted accordingly. If resource constraints exist, monitoring activities will be prioritized based on exposure and risk ratings.
- (3) Criteria are being established for changing obligor risk ratings and facility limits based on the results of both on-going and formal monitoring activities. Controls to ensure risk ratings/ facility limits are updated as appropriate in MBC, CI and the Corporate Exposure Data Mart are also under development.
- (4) Risk transfer activities are currently limited to reinsurance. A mandate for the Relationship and Asset Management (RAM) group is being developed with the objective of enabling additional risk transfer for Insurance exposures via permitted instruments and budgets. The mandate will flow from defined risk appetites/ loss tolerance within the Insurance Group's lines. (Note - this finding was raised once under the ARI Portfolio Management Audit for all Insurance exposures and therefore is marked N.A. for CIB and DCI in Table 2.)
- (5) For common obligors, processes are being established with RMO and RAPM to exchange results of monitoring activities. In conjunction with RMO and RAPM, the feasibility of reducing duplication of effort is being examined by establishing lead monitors on common obligors and leveraging the monitoring results across all teams.
- (6) Processes are being established within CIB and DCI to conduct a loss analysis for claims paid in excess of designated thresholds. The loss analysis will focus on process improvements within underwriting and monitoring activities.
- (7) An approach and timeline is being developed for including DCI and ARI credit exposures with EDC's other credit exposures under a single credit exposure limit framework.

Conclusion

The overall audit opinion has been communicated to, and agreed by, management.

We would like to thank Management for their support throughout these audits.