

**Corporate Portfolio Management -Trade Finance Obligations
Final Audit Report
Report Nr. 18/09
January 15, 2010**

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Introduction

In accordance with our FY2009 Audit Plan, EDC Internal Audit performed an audit of Corporate Portfolio Management for the Trade Finance Obligation (TFO) portfolio. 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 and Insurance Groups 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 loans, guarantees, credit insurance, bonding and trade finance obligations.

Audit Objectives & Scope

This report contains the findings for the audit of the trade finance obligation component of EDC's portfolio. The overall objective of this audit was to review the design effectiveness of the internal controls relating to:

- Changes in credit risk post-origination;
- Credit risk measurement at the portfolio level for the trade finance obligation portfolio; and,
- Credit risk mitigation activities.

In examining corporate portfolio management for trade finance obligations, the audit addressed the following risk elements of EDC's Enterprise Risk Management (ERM) framework: measurement, compliance, financial management and reporting, transaction processing, governance, infrastructure/information, portfolio concentration and capital allocation, system, and reputation.

Audit fieldwork was performed in October, November and December 2009.

Internal Audit Opinion

In our opinion the Corporate Portfolio Management process for the trade finance obligation portfolio is **Well Controlled**¹. No major² control issues were noted. Two moderate issues were noted and are described in the following section.

¹ 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.

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.

Audit Findings & Recommendations

1. Trade Finance Obligation Portfolio - Credit Exposure Reporting

Each quarter, a risk management report is prepared which includes an analysis of the notional and risk weighted credit exposures in aggregate and also by industry sector, country and top obligors and how they compare to policy limits. Credit exposures created through the TFO portfolio are not consistently included in this analysis. Specifically:

- Notional country exposures include TFO but the risk weighted country exposures, the balance that is monitored against policy limits, do not include TFO;
- The Financial & Insurance Services sector exposure (notional and risk weighted) is reported net of TFO; and
- The analysis of top obligor exposures is also reported net of TFO exposures.

We recommend that the Financial Institutions Team (FIT), who manages the TFO portfolio, work with the Risk Management Office (RMO) to develop an approach for including TFO credit exposures with EDC's other credit exposures under a credit exposure limit framework. Once this credit limit exposure framework has been defined, TFO exposures should be included in subsequent reporting.

Rating of Audit Finding - Moderate

Action Owner - Director FIT in conjunction with VP Portfolio Management

Due Dates - Q4 2010

2. Foreign Bank Exposure Monitoring and Oversight

The Director FIT generates a Total Bank Risk report that captures foreign bank exposures generated by all lines of business (except Treasury). Historically this report has not been circulated outside of FIT. The fact that the report amalgamates foreign bank exposures generated across multiple lines of business makes this a valuable reporting and portfolio management tool. On this basis we recommend that FIT circulate the EDC Total Bank Risk report monthly to EDC's RMO.

Rating of Audit Finding - Moderate

Action Owner - Director FIT in conjunction with VP Portfolio Management

Due Dates - Q2 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 Q4 2010.

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