

**Loans Provisioning
Draft Audit Report
Report Nr. 10/11
September 16, 2011**

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Introduction

In accordance with our FY2011 Audit Plan, EDC Internal Audit performed an audit of the Loans Provisioning Process. The purpose of the Loans Provisioning Process is to ensure that losses on loans, loan commitments and guarantees are recorded and disclosed in accordance with International Financial Reporting Standards (IFRS). Loans provisions are a material component of EDC's balance sheet (\$1.839 BCAD at December 31, 2010) consisting of the allowance for losses on loans, commitments, and guarantees.

Audit Objectives & Scope

The overall objective of this audit was to evaluate both the design and operating effectiveness of the controls surrounding the estimation and disclosure of provisions relating to loans, commitments and guarantees. The scope of this audit included testing of the controls in the following areas:

- ✓ Review of provisioning methodology against IFRS;
- ✓ Communication and coordination between loans accounting and other EDC teams who provide inputs into the loans provisioning calculation;
- ✓ Review of the provision calculation inputs;
- ✓ Review of the provision calculation results;
- ✓ Review of the reporting results.

Audit fieldwork was performed from June to August 2011.

Internal Audit Opinion

In our opinion the Loans Provisioning Process is *Well Controlled*¹. We found that key controls to ensure: compliance with International Financial Reporting Standards, communication and coordination between the teams, the reviews of the calculation inputs and calculation results, and the end reporting were designed effectively and operating as intended. One moderate issue was noted and is 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.

Audit Findings & Recommendations

Loss Given Default Estimates

The loss given default (LGD) rate is one of the key inputs into the loans provision calculation. To ensure accuracy and continuing relevance of the LGD rate used, Loans Accounting performs an analysis to compare the LGD to EDC's actual write-off history for impaired loans. While the results of the analysis are discussed at monthly forecasting meetings which are attended by senior finance members, there is no formal process to communicate of the results of the analysis to the Corporate Controller and CFO and to obtain their approval of the LGD rate used. It is recommended that on an annual basis, the LGD analysis and the recommendation to either change or maintain the current LGD rate is formally communicated to the Corporate Controller and CFO and that their approval be documented.

Rating of Audit Finding – Moderate²

Action Owner – Director Corporate Accounting, Corporate Finance & Control

Due Dates - Q4 2011

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 2011.

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

² The ratings of our audit findings are 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.

