



## **Environmental and Social Review at Export Development Canada**

June 2014

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**Office of the Auditor General of Canada  
Bureau du vérificateur général du Canada**

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## Introduction

1. Since 2001, the *Export Development Act* has required Export Development Canada (EDC or the Corporation) to carry out environmental reviews of project-related transactions. To respond to this obligation, EDC introduced an Environmental Review Directive. Under this directive, before entering into a project-related transaction, the Corporation must determine whether

- the project is likely to have adverse environmental effects despite the implementation of mitigation measures, and
- EDC would be justified in entering into the transaction.

EDC also established other environmental review processes for transactions not covered by the Directive.

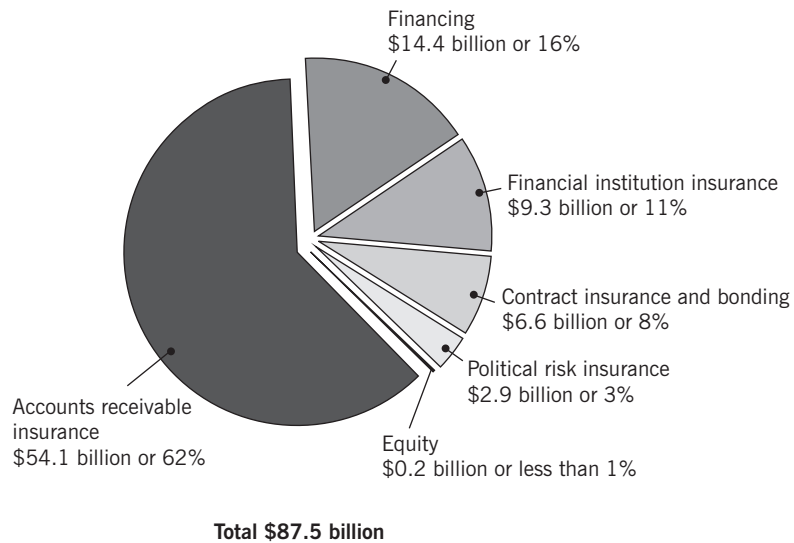
2. The *Export Development Act* gives the Auditor General of Canada a mandate to audit the design and implementation of EDC's Environmental Review Directive at least once every five years and to submit a report to the Corporation's Board of Directors, the Minister of International Trade, and Parliament. This is our fourth report on EDC's environmental review framework. In our June 2009 report, we found that EDC's environmental review processes had most elements of a suitably designed environmental review framework and that they were operating as designed.

### Overview of Export Development Canada

3. EDC is Canada's official export credit agency. As a Crown corporation, its mandate is to support and develop Canada's export trade and Canadian capacity to engage in that trade, and to respond to international business opportunities. The Corporation operates as a commercial financial institution that provides trade finance and risk-mitigation services to Canadian exporters and investors. In March 2014, the Government of Canada introduced amended regulations to clarify the circumstances in which EDC can also provide support in Canada.

4. The primary role of export credit agencies such as EDC is to promote trade in a competitive environment. They can play a significant role in international trade and finance in developing countries that may not have well-established requirements for environmental and social risk management. For example, these agencies are a major source of international public financing for large-scale infrastructure and resource extraction projects in the developing world. Exhibit 1 shows the type of products that EDC provides.

**Exhibit 1 The Corporation's business volume, by types of products**



**The Corporation's Environmental and Social Risk Management Framework**

5. Since 2001, EDC has developed policies and implemented environmental review processes to manage environmental risks and ensure that the projects it supports take environmental issues into account. By applying these policies to potential financing and insurance transactions, EDC can ensure that projects it supports will consider **environmental and social effects** and include mitigation measures, where relevant, to reduce potential negative impacts. In this way, EDC fulfills its statutory requirements and ensures that projects it funds meet international standards for environmental protection.

6. The Corporation's current Environmental and Social Risk Management Framework has the following components:

- The Environmental and Social Risk Management Policy sets out EDC's commitment to assess environmental and social risks in the transaction decision-making process, to advocate best practices with its counterparts, and to strive for high standards of mitigation and monitoring of supported projects, while not unduly hindering the Corporation's ability to support Canadian companies as they compete in global markets.
- The Environmental and Social Review Directive (Exhibit 2) fulfills EDC's statutory obligation to carry out environmental reviews of significant project-related transactions, as required by the *Export Development Act*.

**Environmental and social effects**—Any change to the environment, including any social impact, occurring as a result of the normal construction or operation of a project or in the event of a reasonably foreseeable accident or malfunction in relation to the project. Environmental considerations include protection and conservation of biodiversity, sustainable management and use of renewable resources, efficient production, pollution prevention, and waste minimization, among others. Social impact refers to adverse effects on people as defined in the International Financial Corporation (IFC) Performance Standards for labour and working conditions, community health, safety and security, indigenous peoples, land acquisition and involuntary resettlement, and cultural heritage.

- Other processes supplement the Directive and enable the Corporation to conform to international requirements for significant project-related transactions.
- EDC’s Disclosure Policy sets out both broad disclosure requirements and specific requirements for certain projects reviewed under the Directive.
- Other environmental and social review processes and procedures (Exhibit 3) apply to non-project transactions or transactions involving smaller projects.

7. In addition to these elements, in 2008, the Corporation adopted a Statement on Human Rights. Separate from the Environmental and Social Risk Management Framework, this document sets out EDC’s commitments in relation to human rights.

**Exhibit 2 How the Environmental and Social Review Directive applies to large, project-related transactions at each stage of a review**

**SDR (Special Drawing Rights)**—An artificial currency unit established by the International Monetary Fund and defined as a basket of national currencies. On 30 December 2013, SDR 1.00 was equal to CAN\$1.64.

**Equator Principles**—A set of voluntary guidelines developed by the global banking industry to assist financial institutions in identifying and evaluating environmental and social risks associated with large-scale projects to which they may provide support.

|                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Screening</b></p>      | <p>The Directive applies to financing, political risk insurance, or equity transactions undertaken by Export Development Canada (EDC) under its mandate. A transaction must have a repayment term of two years or more, be related to a project, and either have a value of more than <b>SDR</b>10 million or be located in or near a sensitive area. EDC defines a project as a physical development that is or will be greenfield (undeveloped), or a major extension or transformation of an existing project. In each case, the project is planned or occurring, and is industrial-related, commercial-related or infrastructure-related.</p> <p>For project finance transactions where the total capital cost of a project is greater than US\$10 million, EDC will review the project according to the requirements of the Directive. This enables EDC to meet requirements under the <b>Equator Principles</b>.</p> |
| <p><b>Categorization</b></p> | <p>EDC follows the international practice of categorizing projects according to their potential adverse impact:</p> <p><b>Category A:</b> Projects that are likely to have significant adverse environmental and social effects that are sensitive, diverse, or unprecedented. They may have an impact on a broader area than the project site and they may be irreversible.</p> <p><b>Category B:</b> Projects with potential environmental and social effects that are less adverse than Category A projects. The effects are usually site-specific. Few, if any, of the effects are irreversible, and in most cases mitigation measures can be designed.</p> <p><b>Category C:</b> Projects that are likely to have minimal or no adverse environmental and social effects.</p>                                                                                                                                         |

**Exhibit 2 How the Environmental and Social Review Directive applies to large, project-related transactions at each stage of a review (Continued)**

|                                        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|----------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Information requirements</b></p> | <p>EDC reviews environmental and social information provided by the project sponsors. The required documentation varies according to the project’s category. When a project is located in a Group of Seven (G7) member country and EDC is satisfied that it has been designed to comply with host-country requirements, EDC may determine that no additional information is required beyond that needed for project classification.</p> <p><b>Category A:</b> The project normally requires an Environmental and Social Impact Assessment, or elements of such an assessment, to assist EDC in identifying and assessing potential adverse environmental and social effects.</p> <p><b>Category B:</b> The project requires less information than a Category A project. The amount varies according to the project.</p> <p><b>Category C:</b> The project generally does not require an Environmental and Social Impact Assessment.</p>                                                                                                                        |
| <p><b>Evaluation</b></p>               | <p>At a minimum, the project must comply with the host country’s environmental and social standards. For Category A or B projects in non-G7 countries, EDC uses International Finance Corporation (IFC) Performance Standards as well as any relevant internationally recognized sector-specific or issue-specific standards not addressed by the IFC Performance Standards, such as the World Bank Group Environmental, Health, and Safety Guidelines.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| <p><b>Determination</b></p>            | <p>EDC must determine whether</p> <ul style="list-style-type: none"> <li>• a project is likely to have adverse environmental or social effects despite the implementation of mitigation measures; and</li> <li>• it is justified in entering into the transaction, despite these effects.</li> </ul> <p>Grounds for supporting a project despite adverse environmental and social effects after mitigation measures include the following:</p> <ul style="list-style-type: none"> <li>• after the mitigation measures, the adverse environmental and social effects are not significant;</li> <li>• EDC is satisfied that the project is designed to meet or exceed internationally recognized good practices, guidelines, or standards;</li> <li>• the project represents an opportunity to improve environmental conditions in the host country above baseline conditions; or</li> <li>• the project provides an opportunity to transfer environmentally sound technologies, services, and knowledge to, or for the benefit of, the host country.</li> </ul> |
| <p><b>Covenants and monitoring</b></p> | <p>EDC negotiates financial agreements to include appropriate covenants, warranties, and monitoring provisions.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |



**Exhibit 3 The Corporation's other environmental and social review processes**

| Process                             | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Corporate environmental risk review | <p>This review is for general- and multi-purpose corporate credit facilities not directly related to a project. It is also used for some political risk insurance and other insurance policies. The review assesses the environmental and social risks associated with the relevant operations of the borrower and determines whether the borrower has the capacity to effectively manage these risks. It generally consists of a review of the borrower's environmental and social policies, staffing, management systems and procedures, auditing and reporting, track record, and compliance history. Consideration is also given to the level of confidence EDC has in the information obtained from the borrower.</p> <p>Where more than 50 percent of the financing is intended for a specific project, or more than 50 percent of the required Canadian goods or services are intended for a specific project, a supplemental review of the project is undertaken. This review is similar to a review under the Directive.</p> |
| Environmental risk review           | <p>This review applies to medium- and long-term insurance transactions, project-related transactions not covered by the Directive, and non-project transactions not covered by the Corporate Environmental Risk Review process, each with a value of more than US\$5 million. The review assesses the environmental and social risks associated with a particular transaction.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Officer screening                   | <p>Financing officers and underwriters screen transactions below US\$5 million. They evaluate whether a transaction should be subject to an environmental and social risk review.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| Automated review                    | <p>This review applies to transactions identified by EDC as having minimal environmental risk.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| Exporter declaration                | <p>This requirement applies to contract insurance and bonding, and accounts receivable insurance. EDC requires a declaration from clients that they are not aware of significant environmental risks associated with the business EDC is being asked to support.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |

Note: These processes are not mutually exclusive; for example, while exporters complete a declaration for contract insurance and bonding transactions, such a transaction might still need to undergo an environmental risk review if it meets certain thresholds or criteria.

### Changes since our 2009 report

8. In 2010, EDC introduced policy changes reflecting its commitment to include social issues in its review processes, alongside environmental issues. EDC also

- adopted the **International Finance Corporation (IFC) Performance Standards** as its primary reference for environmental and social project performance in developing countries. This responds to our 2009 recommendation related to formalization of guidance on the selection of international benchmarks;
- made climate change a strategic priority of EDC's commitment to Corporate Social Responsibility. This change allows EDC to better understand and assess the carbon and climate risks and opportunities associated with its customers' businesses; and
- undertook to provide more information on Category A projects supported by EDC—that is, projects likely to have significant adverse environmental and social effects (Exhibit 2).

9. In 2011, EDC became the first export credit agency and Canadian financial institution to be elected to the Steering Committee of the Equator Principles Association. The committee coordinates the administration, management, and development of the Equator Principles on behalf of the Association's member financial institutions. As an Equator Principles Financial Institution, EDC was actively engaged in the IFC Performance Standards review process. EDC began applying the updated IFC Performance Standards during 2012.

### Focus of the audit

10. As required by the *Export Development Act*, our audit focused on

- the suitability of the design of EDC's Environmental and Social Review Directive and other environmental and social review processes (through assessment of the documented policies, processes, and procedures against stated criteria); and
- the implementation of the Corporation's Environmental and Social Review Directive and other environmental and social review processes, to determine whether these processes are implemented as designed.

11. In our 2009 audit, we evaluated EDC's Environmental Review Directive and other environmental and social review practices, using as benchmarks the Organisation for Economic Co-operation and Development (OECD) Common Approaches and the Equator

**International Finance Corporation (IFC) Performance Standards**—IFC, a member of the World Bank Group, is a global development institution focused exclusively on the private sector in developing countries. The IFC Performance Standards on Environmental and Social Sustainability are designed to help project sponsors identify, evaluate, avoid, mitigate, and manage environmental and social risks and impacts. The IFC Performance Standards are the primary reference for financial institutions and export credit agencies to assess environmental and social risks under Equator Principles and the Organisation for Economic Co-operation and Development (OECD) **Common Approaches**.

**Common Approaches**—OECD recommendation setting out common procedures and processes for export credit agencies to follow when they conduct environmental reviews of projects for which they have provided support. Originally issued in 2003, the document was updated in June 2012 to include social reviews and was retitled *Recommendation on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence*.

Principles, since these were the internationally recognized practices at the time. For this audit, we considered internationally recognized practices in the area of environmental and social review and found that the Common Approaches and the Equator Principles remain the recognized benchmarks. We also reviewed how EDC had responded to the recommendations we made in our 2009 report.

12. The audit covered the period from 1 January 2012 to 30 September 2013. More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this report.

## Observations and Recommendations

### Design of review processes for significant projects

#### The Corporation's processes meet the requirements of the OECD Common Approaches and the Equator Principles

13. Banks and export credit agencies are important sources of financing for projects. In December 2003, Canada and other member countries of the Organisation for Economic Co-operation and Development (OECD) adopted the Common Approaches. In 2003, 10 members of the private banking sector adopted the Equator Principles (EP) to ensure that projects receiving financing are developed in a manner that is environmentally sound. Currently, 78 financial institutions in 35 countries, including six large Canadian banks, have adopted the EP. Four export credit agencies—Denmark's Eksport Kredit Fonden, Australia's Export Finance and Insurance Corporation, the Export-Import Bank of the United States, and Export Development Canada (EDC)—have also adopted them.

14. We examined whether the Corporation's Environmental and Social Review Directive and other elements of its Environmental and Social Risk Management Framework meet the requirements of the OECD Common Approaches and the Equator Principles, as indicated in EDC's corporate reports.

15. We benchmarked EDC's processes against the updated Common Approaches (June 2012), which emphasize

- more explicit consideration of social and environmental impacts,
- the importance of encouraging the protection and respect of human rights, and
- the need to address greenhouse gas emissions.

We also benchmarked EDC's processes against the 2006 version of the EP, which was in effect during the period under review. The revised EP came into effect on 4 June 2013, with a transition period from that date to 31 December 2013.

**16.** We found that EDC's Environmental and Social Review Framework incorporates all of the requirements of the OECD Common Approaches and of the Equator Principles. The Directive is closely aligned with the Common Approaches. For transactions that trigger a review under the Equator Principles, EDC has a supplementary Equator Principles process; this complements requirements in the Directive and ensures that the various EP requirements not explicitly covered by the Directive are addressed by the Corporation when it performs reviews. Examples of requirements unique to the Equator Principles include independent reviews of projects by environmental and social experts, and independent monitoring and reporting after a loan has been executed.

**17.** EDC's Equator Principles procedure formalized the Corporation's practices for projects requiring review under the Principles. It also addressed a recommendation in our 2009 report, calling for improved documentation to demonstrate that EP requirements were being addressed. The procedure requires the Corporation's environmental advisors to confirm that a project conforms to the Equator Principles in their detailed project review memos. A similar supplementary process is used for the OECD Common Approaches. It deals with one particular type of contract and insurance bonding transaction not covered under the Directive.

#### **The Corporation has developed a policy related to greenhouse gas emissions**

**18.** In our 2009 audit report, we noted that it had become an emerging practice for export credit agencies to track greenhouse gas emissions from financed projects. In its response to our observation related to the tracking of greenhouse gas emissions, EDC indicated that it would consider this issue as part of its next environmental policy review. In the course of this audit, we examined whether EDC had included climate change considerations in its Environmental and Social Risk Management Policy.

**19.** We found that EDC has developed a procedure for assessing greenhouse gas emissions. The procedure requires EDC to assess all Category A and Category B projects under review that produce more than 25,000 tonnes of **carbon dioxide equivalent** annually or are expected to do so. It requires the project sponsor to provide

**Carbon dioxide equivalent**—Quantification of emissions of different greenhouse gases, expressed in terms of amount of carbon dioxide.

documentation to demonstrate that climate change risks have been considered. EDC's procedure requires that the project sponsors

- provide an estimate of greenhouse gas emissions, measured according to internationally recognized methodologies and good practices; and
- consider alternatives and implement technically and financially feasible options to reduce project-related greenhouse gas emissions during the design and operation of the project.

20. We found that EDC's requirements are aligned with the 2012 International Finance Corporation (IFC) Performance Standards and go beyond what is explicitly required under the 2012 OECD Common Approaches. The Equator Principles in effect at the time of our audit did not contain an explicit reference to greenhouse gas emission risks; however, the revised Equator Principles issued in June 2013 include requirements similar to those in the IFC Performance Standards.

**The Corporation reviews the design of its environmental and social review processes for consistency with international practices**

21. Standards and benchmarks in the area of environmental and social assessments are constantly evolving. We examined whether EDC monitors developments on an ongoing basis, and identifies when and how its processes need revision to ensure that they remain consistent with international standards and practices.

22. In 2010, EDC adopted its current Environmental and Social Risk Management Policy and Environmental and Social Review Directive. We found that both are required to undergo periodic review and updating. This ensures that the policy and associated Directive and procedures will continue to reflect current practices in the area of environmental and social review.

23. In addition, EDC keeps abreast of emerging developments in international standards and requirements through its participation in the EP Association Steering Committee, IFC-sponsored workshops, and regular meetings with the export credit agencies of other OECD member countries.

24. Furthermore, EDC hosts a Corporate Social Responsibility Advisory Council, which meets twice a year with the Corporation to advise and guide it on matters related to evolving best practices in

this area. Discussions with members of the Advisory Council have confirmed that EDC is up to date with current practices in the area of corporate social responsibility.

### **Implementation of review processes for significant projects**

#### **The Corporation screens its transactions according to its Environmental and Social Risk Management Policy**

25. To assess Export Development Canada's implementation of its environmental and social review processes, including the Environmental and Social Review Directive, we examined a sample of transactions across all products to assess how the Corporation screens its transactions to determine which review process should apply.

26. As discussed in Exhibit 2, the Directive applies only to project-related financing, political risk insurance, and equity transactions that have a value of over SDR10 million or are in or near a sensitive area, and which have a repayment term of two years or more. In cases where the Directive does not apply, but a project would trigger a review under the Equator Principles, EDC will screen and review the project according to the requirements of the Directive (and its Equator Principles process, as described in paragraphs 16 and 17). Transactions not subject to the Directive are covered by the other environmental and social review processes outlined in Exhibit 2. We found, for the transactions examined, that the Corporation had screened its various types of transactions appropriately.

#### **The Corporation has implemented its Environmental and Social Review Directive as designed**

27. Exhibit 2 outlines the steps in performing a review under the Directive. We examined whether EDC was complying with the requirements of the Directive in the areas of categorization, identification of information requirements, evaluation, definition of covenants, and monitoring after loan agreements have been signed.

28. Under the Directive, projects are categorized based on their potential for adverse environmental and social effects. This categorization process follows common international practices that identify projects as falling into A, B, or C categories (see Exhibit 2). For transactions examined, we found that EDC categorized its projects according to its Directive, consistent with the Organisation for Economic Co-operation and Development (OECD) Common Approaches and the Equator Principles. Based on the categorization, information requirements were found to comply with those of the Directive.

29. With respect to project evaluation, the EDC Directive uses the International Financial Corporation (IFC) Performance Standards, with some exceptions. Where the project is located in a country that belongs to the Group of Seven (G7), the host country's environmental requirements apply. In other jurisdictions, EDC may evaluate a project against host country requirements or other internationally recognized standards if they are considered to be at least equivalent to, or more stringent than, the IFC Performance Standards.

**There are some weaknesses in monitoring the implementation of agreements**

30. EDC imposes loan agreement covenants or provisions in insurance policies to ensure that projects receiving support will be constructed and operated as designed, in keeping with environmental and social requirements and commitments made by the project sponsor. EDC may determine that a project does not fully meet required social and environmental standards, but may conclude that the gaps can be addressed over time. In such cases, the Corporation secures the borrower's commitment to address the gaps through a lender action plan included in the loan agreement. For the transactions examined, we assessed whether such covenants or loan provisions were included, and whether they were being followed up on as required.

31. EDC's Environmental and Social Review Directive provides for monitoring after the loan agreement has been signed to confirm that conditions are being respected. We found that the Corporation is monitoring environmental and social covenants on approved projects as required by the Directive. Monitoring is generally done by reviewing reports from the project sponsor or other means, such as site visits.

32. The Corporation's monitoring system for environmental and social commitments relies on manual inputs and interventions that are carried out by multiple departments within EDC. The use of manual inputs makes the monitoring system vulnerable to human errors or omissions, especially when the responsibility is shared (or not located in one department). The integrity and comprehensiveness of the tracking spreadsheet may be affected. For example, we noted instances where covenants from recently approved project loans had not been included or had been incorrectly entered in the tracking spreadsheet, as well as instances where deadlines had been missed. Consequently, we were unable to observe follow-ups on missing documents or reports in a few cases. In the case of one Category A project, covenants were not recorded internally for tracking purposes, and there were delays in receiving monitoring reports and action items. As a result,

EDC advisors had to communicate directly with the borrower and consultant from time to time in order to get the information needed to assess whether the project was respecting environmental and social requirements.

**33.** The weaknesses we observed in monitoring expose EDC to the risk that a project for which it provided funding may fail to comply with agreed conditions, and that EDC will not become aware of the non-compliance early enough to mitigate the potential environmental or social impact.

**34. Recommendation.** Export Development Canada (EDC) should strengthen its controls for monitoring projects after agreements have been signed to ensure that they are effective in documenting all covenants on environmental and social issues, and that monitoring reviews and follow-ups are carried out in a timely manner.

*The Corporation's response.* The Corporation agrees with the recommendation to further strengthen our procedures and controls for monitoring projects after agreements have been signed. EDC's Internal Audit team recently conducted an audit and had similar findings that are slated to be rectified this year. In addition, other improvement measures have been identified and further analysis of our various monitoring systems will be undertaken in 2014. EDC remains committed to monitoring projects as an integral part of its environmental and social risk management process.

#### **Gaps exist in the Corporation's assessments of project documentation on greenhouse gas emissions**

**35.** Since 2010, EDC's policy and procedures have called for compliance with the requirements of the IFC Performance Standards and the OECD Common Approaches. During our audit, the Corporation was still making the transition to these new requirements.

**36.** We examined how EDC was implementing its greenhouse gas procedure when performing reviews of projects under the Directive or related review processes. The procedure came into effect in December 2011, shortly before the start of our examination. The requirements of the procedure are described in paragraph 19.

**37.** Overall, we found that EDC was applying its greenhouse gas procedure. However, we observed inconsistencies in the documentation of greenhouse gas emission levels in several project reviews. As a result, it was difficult for us to assess the extent to which emissions were considered in some of the reviews that we examined. Furthermore, we found that the information provided by project



sponsors did not always indicate whether they had considered alternatives that would reduce greenhouse gas emissions. In one of our transaction reviews involving a Category A project, we noted that the estimate covered only a part of the project, and that emissions for the project as a whole were significantly higher than those originally provided to EDC.

**38. Recommendation.** Export Development Canada (EDC) should ensure that project sponsors provide consistent documentation of projected greenhouse gas emission levels for their projects, as well as alternatives that they considered to reduce emissions. The Corporation should also strengthen its procedures and internal capacity with regard to greenhouse gas emissions so that it can assess whether the emission estimates provided by project sponsors and their expert consultants are reasonable.

*The Corporation's response.* EDC agrees with the Office's recommendation to strengthen its procedures and internal capacity to collect consistent project documentation on projected greenhouse gas emission levels and alternatives to reduce emissions. Inclusion of greenhouse gas emissions data in environmental impact assessments is still relatively new for many project sponsors, and this contributes to inconsistencies in the data received. In addition, common review parameters and tools for financial institutions and export credit agencies to assess greenhouse gas risks are still emerging. In 2014, we will assess our training needs and also review our procedures to ensure our documentation requirements are clear and reflect emerging practices for financial institutions. We will also continue to engage with other export credit agencies on this topic as part of building a body of experience within the framework of the Organisation for Economic Co-operation and Development Common Approaches.

## Other review processes

### **The Corporation has implemented its other environmental review processes as designed**

**39.** As discussed previously, Export Development Canada (EDC) has designed and implemented other environmental and social review processes to manage risks that are not addressed by the Environmental and Social Review Directive and related processes for reviewing large projects. These processes include the corporate environmental risk review, other environmental risk reviews, officer screenings, and exporter declarations. (Exhibit 3 explains these processes and their application.) These processes are outside the requirements of the Organisation for Economic Co-operation and Development (OECD) Common Approaches and the Equator Principles, and thus outside the scope of our conclusion on EDC's Environmental and Social Review

Directive. However, we examined them to assess the overall coherence of the Corporation's Environmental and Social Risk Management Framework. We also assessed whether these processes are operating effectively as designed.

40. We reviewed a sample of transactions to evaluate the implementation of the Corporation's other environmental and social review processes. In examining the files associated with the selected transactions, we looked for evidence of compliance with the key elements of the particular review. We also interviewed EDC staff, including in financial services, to discuss actions they had taken and judgments they had made.

41. Based on the results of this review, we found that the design of EDC's other environmental review processes is consistent with its overall Environmental and Social Risk Management Policy. For the transactions examined, we also found that EDC implemented its other environmental and social review processes as designed, during the period from January 2012 to September 2013.

**Corporate Environmental Risk Review processes have improved, but some opportunities for refinements exist**

42. Much of EDC's support for business involves corporate lending, such as multi-purpose or general-purpose corporate loans. This type of transaction can also include loans to financial institutions, which contribute to the financial institution's lending portfolio, but the ultimate use of the funds is unknown to EDC. Multi-purpose and general-purpose corporate loans that are not associated with a specific project undergo a different type of review—one that assesses environmental and social risks associated with the borrower. (Exhibit 3 provides details about the corporate environmental risk review.) This type of review is beyond the requirements of the OECD Common Approaches and the Equator Principles. Consequently, a minority of export credit agencies or Equator Principles Financial Institutions have processes and procedures in this area. We examined a sample of transactions reviewed under the corporate environmental risk review to assess how EDC was applying its procedures.

43. As part of a corporate environmental risk review, advisors perform database searches to evaluate a borrower's environmental and social track record. To assess the borrower's management capacity for addressing environmental and social risks, the advisors may consult a number of other sources, including documentation provided by the borrower, the corporate website, Internet searches, or third-party

reports. EDC may rely solely on publicly available information if it is deemed to be sufficient for this part of its review. However, advisors may also identify additional information needs based on their professional judgment of the risk associated with the transaction.

**44.** Since our last audit, EDC engaged consultants to review its processes for corporate environmental risk review and made improvements based on their recommendations. Despite these positive steps, we found opportunities to refine the procedures further, especially related to gauging various factors when assigning risk ratings. In certain cases, we noted different risk ratings assigned to similar situations, with little documentation explaining the differences. This could expose EDC to inconsistencies in the way it documents and assesses the risks associated with transactions, which could result in decisions based on incomplete or inaccurate information.

**45. Recommendation.** Export Development Canada (EDC) should consider providing more precision and guidance for risk ratings, as well as standardizing documentation requirements. This would ensure that the associated risks are properly and consistently assessed, supported, and documented.

*The Corporation's response.* The Corporation agrees with the recommendation to make refinements to its Corporate Environmental Risk Review processes by providing more precision for risk ratings and standardizing documentation requirements. EDC has already embarked on a process to refine our Corporate Social Responsibility risk rating methodologies for these transactions. This work will continue in 2014, with completion expected in 2015.

#### **Social considerations could be better integrated into procedures**

**46.** As discussed previously, in the last five years, EDC updated its Environmental and Social Risk Management Framework to integrate social risks more explicitly into its considerations. The Corporation's Environmental and Social Review Directive as well as its Environmental and Social Risk Management Policy reflect the new approach. They are in line with international standards, which now call for the same attention to social and environmental concerns when considering project impacts. During our audit, we noted many cases of project reviews where social concerns received prominent consideration.

**47.** In other instances, we found that social risks were not taken into consideration as fully as environmental risks. For example, in some cases, documentation of the review did not include evidence of the

attention paid to a borrower's capacity to address relevant social risks. We noted such instances in Corporate Environmental Risk Reviews, where risk ratings were assigned on a general basis by placing environmental and social risks together in one category. In the case of exporter declarations, which are required for Accounts Receivable Insurance transactions, the customer is expected to self-identify its risks. The exporter is prompted to consider environmental risks as well as certain social risks, but not all. In these cases, screening for social risks may be limited unless the transaction undergoes additional review processes. These limitations made it difficult for us to determine whether the social impact of a transaction receives adequate consideration.

**48. Recommendation.** To support better decision making and demonstrate consideration of social concerns related to transactions, Export Development Canada (EDC) should update its procedures to give explicit direction on how to analyze social concerns. It should also appropriately document the concerns considered, or the reasons why social concerns were not considered.

***The Corporation's response.** The Corporation agrees with the recommendation and will schedule a review of existing procedures to identify any gaps so they can be rectified. As noted by the Office's audit team, EDC has rigorously tracked developments in the field of social risk assessment. We maintain a highly qualified team of environmental and social experts knowledgeable on a range of issues. Social risks often take a prominent role in our reviews. We will work to ensure that our procedures fully reflect the weight given to social risks in our assessments.*

## Oversight and monitoring

### **The Corporation has oversight and other practices in place to ensure the ongoing effectiveness of the environmental and social review processes**

**49.** The effectiveness of environmental and social review processes at Export Development Canada (EDC) depends on the competence of the Corporation's staff:

- financial officers, who receive and review information supplied to them by the exporters; and
- environmental advisory services officers, who assess and provide advice on transactions that have environmental and social risks.

Also important is the task of monitoring and reporting on policy obligations and implementation; this makes it possible to hold management accountable for the effectiveness of its practices, and to convey to stakeholders how well the Corporation is meeting its commitments.

**50.** We examined whether the Corporation has oversight practices in place to ensure and monitor the ongoing effectiveness of its environmental and social review processes, including proper quality review practices, training, monitoring, reporting, and disclosure. We found that EDC has various practices and processes in place to address oversight and ensure the effectiveness of its review processes. Key practices are described below.

**51.** The Risk Management Committee is a committee of the Board of Directors. It receives quarterly reports from EDC management on environmental advisory services activities. The reports include a summary of activities undertaken in the previous quarter and details of signed transactions reviewed under the Environmental and Social Review Directive, the Organisation for Economic Co-operation and Development (OECD) Common Approaches, and the Equator Principles.

**52.** EDC's Environmental Advisory Services group and the Employee Development Department are jointly responsible for identifying training needs. We also noted that the Environmental Advisory Services group developed courses and provided training, including online training modules and tutorials, to respond to the development needs of financial officers and underwriters in the area of oversight and monitoring.

**53.** EDC discloses information on approved Category A and Category B projects on its website. The Corporation discloses the type of environmental information used to review each project as well as the standards used. Since 2011, EDC has provided additional information on Category A projects that receive its support. Project summaries describe EDC's review, as well as key environmental and social issues and mitigation measures for the projects.

**54.** In addition, the Corporation's Internal Audit group carries out regular internal audits of EDC's implementation of its Corporate Social Responsibility policies and practices. The audits, which are made public on EDC's website, also provide assurances concerning the effectiveness of EDC's systems and practices.

**55.** As required by the Common Approaches, EDC semi-annually submits to the OECD Secretariat the information required on both Category A and Category B projects. Moreover, the Corporation provides information to the OECD when it surveys its members about implementation of the Common Approaches.

## Conclusion

**56.** We concluded that Export Development Canada's Environmental and Social Review Directive and other environmental review processes for significant projects were suitably designed, as they met the requirements of the Organisation for Economic Co-operation and Development's Common Approaches and the Equator Principles. We also concluded that the Environmental and Social Review Directive and other environmental review processes for significant projects were implemented as designed for the period from 1 January 2012 to 30 September 2013. During the period under examination, the Equator Principles were updated, but we did not consider the changes in conducting our audit because the implementation date for the changes was outside the time frame of the audit.

**57.** We also concluded that other review processes were suitably designed and effectively implemented, that the Corporation regularly reviews the suitability of its environmental and social review processes, and that it is monitoring and reporting on its environmental and social policies and review processes.

**58.** Finally, we concluded that recommendations from our 2009 report had been addressed to our satisfaction. The recommendations were related to formalizing guidance on selecting an international benchmark, documenting compliance with requirements in documentation reviews, and tracking greenhouse gas emissions.

## About the Audit

The Office of the Auditor General’s responsibility was to conduct an independent examination of the Environmental and Social Review Directive and other environmental and social review processes of Export Development Canada (EDC), so that it could provide objective information, advice, and assurance to assist Parliament in its scrutiny of the government’s management of resources and programs.

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set out by the Chartered Professional Accountants of Canada (CPA) in the CPA Canada Handbook—Assurance. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

As part of our regular audit process, we obtained management’s confirmation that the findings reported in this report are factually based.

### Objectives

This audit covered the Environmental and Social Review Directive and other environmental and social review processes of Export Development Canada. We reviewed the design of these processes and related procedures to determine whether they included, as stated in EDC’s corporate reports, activities and practices consistent with the Organisation for Economic Co-operation and Development (OECD) Common Approaches and with the Equator Principles.

As required under section 21(2) of the *Export Development Act*, our audit objectives addressed

- the suitability of the design of the Corporation’s Environmental and Social Review Directive and its other environmental and social review processes (through assessment of its documented policies, processes, and procedures against stated criteria); and
- the implementation of the EDC’s environmental review processes, to determine the extent to which the requirements of these processes were being complied with.

### Scope and approach

In our 2009 audit, we evaluated EDC’s Environmental Review Directive and other environmental review practices, using as benchmarks the OECD Common Approaches and the Equator Principles, which were the internationally recognized practices at the time. For this audit, we considered internationally recognized practices in the area of environmental and social review. We found that the OECD Common Approaches and the Equator Principles remain the recognized benchmarks.

We reviewed how EDC monitors international developments in the design of environmental and social review frameworks, and how it ensures that its own processes remain consistent with international best practices.

We reviewed the extent to which EDC had implemented its environmental and social review processes for the period from 1 January 2012 to 30 September 2013, and whether the implementation was consistent with the design of these processes. We also reviewed the extent to which the Corporation had implemented the recommendations set out in our June 2009 report.

Our audit relied, in part, on the findings and conclusions of an internal audit performed by the Corporation. The objectives and criteria for the internal audit were comparable to our audit objectives, criteria, and subject matter. We were able to rely on the audit work performed by EDC’s Internal Audit group in compliance with audit standards of The Canadian Professional Accountants of Canada.

We conducted interviews with EDC’s management and reviewed documents, including policies, procedures, committees’ terms of reference, minutes, reports, and a judgmental selection of transactions. We compared the elements of EDC’s Directive and other environmental and social review processes and procedures with each of the elements of the OECD Common Approaches and the Equator Principles (including the requirements of the International Finance Corporation Performance Standards, where appropriate).

**Criteria**

| Criteria                                                                                                                                                                                                                                                                                      | Sources                                                                                                                                                                       |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>To determine whether Export Development Canada’s Environmental and Social Review Directive and the Corporation’s other environmental and social review processes were suitably designed, we used the following criteria:</b>                                                               |                                                                                                                                                                               |
| The Corporation’s Environmental and Social Review Directive and other environmental and social review processes meet, as stated in its corporate reports, the requirements of the Equator Principles and the Organisation for Economic Co-operation and Development (OECD) Common Approaches. | <ul style="list-style-type: none"> <li>• Environmental and Social Risk Management Policy, Export Development Canada, 2010</li> </ul>                                          |
| The Corporation reviews the suitability of its environmental and social review processes to ensure that they remain consistent with international standards and practices.                                                                                                                    | <ul style="list-style-type: none"> <li>• <i>Export Development Act</i></li> <li>• Environmental and Social Risk Management Policy, Export Development Canada, 2010</li> </ul> |
| <b>To determine whether Export Development Canada’s Environmental and Social Review Directive and the Corporation’s other environmental and social review processes were implemented as designed, we used the following criteria:</b>                                                         |                                                                                                                                                                               |
| The Corporation monitors and reports on its environmental and social review policies and processes, including the Equator Principles and the OECD Common Approaches.                                                                                                                          | <ul style="list-style-type: none"> <li>• Environmental and Social Risk Management Policy, Export Development Canada, 2010</li> </ul>                                          |
| The Corporation complies with the requirements of its environmental and social review processes.                                                                                                                                                                                              | <ul style="list-style-type: none"> <li>• <i>Export Development Act</i></li> <li>• Environmental and Social Risk Management Policy, Export Development Canada, 2010</li> </ul> |
| The Corporation has practices in place to ensure that its workforce has the training and skills required to implement its environmental and social review processes.                                                                                                                          | <ul style="list-style-type: none"> <li>• Environmental and Social Risk Management Policy, Export Development Canada, 2010</li> </ul>                                          |

Management reviewed and accepted the suitability of the criteria used in the audit.



**Period covered by the audit**

The audit covered the period between 1 January 2012 and 30 September 2013. Audit work was completed on 13 January 2014.

**Audit team**

Assistant Auditor General: Clyde MacLellan

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## Appendix List of recommendations

The following is a list of recommendations found in the report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

| Recommendation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Response                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Implementation of review processes for significant projects</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <p><b>34.</b> Export Development Canada (EDC) should strengthen its controls for monitoring projects after agreements have been signed to ensure that they are effective in documenting all covenants on environmental and social issues, and that monitoring reviews and follow-ups are carried out in a timely manner. (30–33)</p>                                                                                                                                                                                | <p>The Corporation agrees with the recommendation to further strengthen our procedures and controls for monitoring projects after agreements have been signed. EDC’s Internal Audit team recently conducted an audit and had similar findings that are slated to be rectified this year. In addition, other improvement measures have been identified and further analysis of our various monitoring systems will be undertaken in 2014. EDC remains committed to monitoring projects as an integral part of its environmental and social risk management process.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| <p><b>38.</b> Export Development Canada (EDC) should ensure that project sponsors provide consistent documentation of projected greenhouse gas emission levels for their projects, as well as alternatives that they considered to reduce emissions. The Corporation should also strengthen its procedures and internal capacity with regard to greenhouse gas emissions so that it can assess whether the emission estimates provided by project sponsors and their expert consultants are reasonable. (35–37)</p> | <p>EDC agrees with the Office’s recommendation to strengthen its procedures and internal capacity to collect consistent project documentation on projected greenhouse gas emission levels and alternatives to reduce emissions. Inclusion of greenhouse gas emissions data in environmental impact assessments is still relatively new for many project sponsors, and this contributes to inconsistencies in the data received. In addition, common review parameters and tools for financial institutions and export credit agencies to assess greenhouse gas risks are still emerging. In 2014, we will assess our training needs and also review our procedures to ensure our documentation requirements are clear and reflect emerging practices for financial institutions. We will also continue to engage with other export credit agencies on this topic as part of building a body of experience within the framework of the Organisation for Economic Co-operation and Development Common Approaches.</p> |

| Recommendation                                                                                                                                                                                                                                                                                                                                                                          | Response                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Other review processes</b>                                                                                                                                                                                                                                                                                                                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <p><b>45.</b> Export Development Canada (EDC) should consider providing more precision and guidance for risk ratings, as well as standardizing documentation requirements. This would ensure that the associated risks are properly and consistently assessed, supported, and documented. (42–44)</p>                                                                                   | <p>The Corporation agrees with the recommendation to make refinements to its Corporate Environmental Risk Review processes by providing more precision for risk ratings and standardizing documentation requirements. EDC has already embarked on a process to refine our Corporate Social Responsibility risk rating methodologies for these transactions. This work will continue in 2014, with completion expected in 2015.</p>                                                                                                                             |
| <p><b>48.</b> To support better decision making and demonstrate consideration of social concerns related to transactions, Export Development Canada (EDC) should update its procedures to give explicit direction on how to analyze social concerns. It should also appropriately document the concerns considered, or the reasons why social concerns were not considered. (46–47)</p> | <p>The Corporation agrees with the recommendation and will schedule a review of existing procedures to identify any gaps so they can be rectified. As noted by the Office’s audit team, EDC has rigorously tracked developments in the field of social risk assessment. We maintain a highly qualified team of environmental and social experts knowledgeable on a range of issues. Social risks often take a prominent role in our reviews. We will work to ensure that our procedures fully reflect the weight given to social risks in our assessments.</p> |