

**Investments Audit
Report # 3/15
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Distribution:

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Introduction

In accordance with our 2014 Audit Plan, EDC Internal Audit performed an audit of the Investments Program. EDC's Investments Program provides both capital and venture capital solutions to Canadian SMEs in an effort to support the growth of their international platforms. This is achieved through both direct investments in Canadian SMEs, as well as indirect investments through Canadian Venture Capital and Mid-Market Private Equity Funds. The program is also an active investor in international mid-market and infrastructure private equity funds, particularly in emerging markets, that are leveraged to create Canadian trade benefits. At the end of 2014, EDC's investment portfolio consisted of 74 active fund investments with a Fair Value (FV) of approximately \$617M CAD, while EDC's direct investment portfolio included 28 active investments with a FV of approximately \$72M CAD. There was also a further \$672M CAD in undrawn commitments, of which \$655M CAD was allocated to fund investments.

Audit Objectives & Scope

The overall objective of the audit was to evaluate the design and operating effectiveness of the Investments process within the scope of testing internal controls pertaining to deal analysis and approvals, and monitoring and valuation of investments. The detailed fieldwork was performed between December 2014 and January 2015.

Internal Audit Opinion

In our opinion, we have concluded that controls surrounding the Investments process, as described above, are “**Well Controlled**”¹. Through our detailed testing, we have verified that key controls over investments at origination, monitoring and valuation, and reconciliations with investment fund statements are effectively designed and operating as intended. Two moderate² issues were noted and are described in the following sections.

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 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.

Audit Findings & Action Plans

1. Investments Portfolio Monitoring

EDC receives quarterly Fund Reports from the various Fund Managers. These reports indicate estimated fair market value for the funds, and they also summarize the transactions that have occurred during the quarter. Statements are generally received 45 to 60 days after quarter end. At the end of 2014, EDC had invested \$615M CAD in 74 Funds with a further \$655M CAD remaining in undrawn funding commitments, representing a material allocation of EDC's capital.

We noted that the reconciliation for undrawn commitments between Fund Reports received and PEO balances was not being completed. The reconciliation between Private Equity Office (PEO) system transactions and the Fund Reports should be performed on a periodic basis to ensure that data entered into PEO by Loans Services was correctly input and classified and to ensure that EDC has received notification of all transactions impacting the Fund, as well as reconciling the amounts held in escrow by the Funds.

Management has agreed to reconcile the fair value and undrawn commitments on the Fund statements to PEO balances on a semi-annual basis and update the Portfolio monitoring guidelines accordingly.

Rating of Audit Finding – Moderate

Action Owner – Director, Corporate Accounting

Due Date – Q2, 2015

2. Sale of Shares

Except for the sale of shares in the Investments portfolio, EDC's Risk Transfer team is generally responsible for disposing of EDC's assets. IA noted that the Investments team arranged for the sale of shares in six direct investments in 2014 through directly engaged independent brokers. Varying commission and discount rates were agreed with the brokers by Investments in connection with the shares sold.

The Risk Transfer team is well established with the financial vehicles, relationships, relationship terms and tools to execute asset disposals on a recurring basis. Synergies, efficiencies and controls may be enhanced if responsibility for the sale of shares were shifted to the Risk Transfer team.

Management has agreed to investigate the feasibility of transferring the responsibility for the sale of shares acquired through Investments to the Risk Transfer team.

Rating of Audit Finding - Moderate

Action Owner – VP, Investments

Due Date – Q2, 2015

Conclusion

The audit findings and action plans have been communicated to and agreed by management, who has developed action plans that are scheduled for implementation no later than Q2, 2015. We would like to thank management for their support throughout the audit.