

**Credit Risk Analysis & Pricing Audit:
Structured & Project Finance
Final Report
Report Nr. 20/15
December 8, 2015**

Distribution:

To: President & CEO
Senior Vice-President & Chief Financial Officer
Senior Vice-President, Financing & Investments
Vice-President & Corporate Controller
Vice-President, Structured & Project Finance
Director, Structured & Project Finance

CC: Senior Vice-President, Business Development
Senior Vice-President, Business Solutions & Innovation
Senior Vice-President & Chief Risk Officer
Senior Vice-President, Corporate Affairs and Secretary
Senior Vice-President, Human Resources and Communications
Senior Vice-President, Insurance
Director, Stakeholder Relations & Planning
Principal, Office of the Auditor General
Director, Office of the Auditor General

Audit Team:
Ramesh Baddepudi
Souhail Sadaka
Muhammad Abid

Vice President, Internal Audit
Monica Ryan

Table of Contents

Introduction 3

Audit Objectives & Scope..... 3

Internal Audit Opinion..... 3

Audit Findings & Action Plans..... 3

Conclusion..... 4

Introduction

As per our 2015 Audit Plan, Internal Audit performed an audit of transactional credit analysis, pricing, structuring and DOA activities within the Structured & Project Finance (SPF) underwriting process. EDC provides Project Financing type lending, which involves long-term financing of infrastructure and industrial projects where the repayment is based on projected cash flows of the project. EDC typically focuses on those projects which fall within three key segments: infrastructure and industrials; power and utilities; and extractive (oil & gas, mining, metals and resources), where there are demonstrated economic benefits to Canada, either through the support or development of exports. In the past year, EDC has created 20 new SPF facilities amounting to approximately \$2B in funding.

Audit Objectives & Scope

The overall objectives of this audit were to review the controls pertaining to transactional credit analysis, pricing, structure, and DOA. The scope of this audit included an evaluation of both the design and operating effectiveness of the related controls. Transactional testing related to credit analysis, pricing, structure and DOA, covered the period from August 2014 through the end of July 2015.

Internal Audit Opinion

Based on the results of our audit, we have concluded transactional credit analysis, pricing, structuring, and DOA activities for SPF are “*Well Controlled*”¹. Detailed SPF underwriting guidelines do not currently exist, however, sector-specific risk rating guidelines issued by S&P and Moody’s are used by the team in the absence of SPF-specific guidelines. We tested a sample of transactions against Moody’s guidelines and found no significant issues. Recognizing the benefit of having EDC-specific guidelines, management has developed an action plan to implement SPF underwriting guidelines by Q4 2017. This will allow the guidelines to be tailored to complement the new SPF risk rating model which is being implemented in the latter part of 2016.

Audit Findings & Action Plans

Finding #1 – Underwriting Guidelines

Given the specialized nature of SPF activities, comprehensive underwriting guidelines, by sector, are essential to ensuring consistency in lending decisions and a robust overall lending process. We found that no separate underwriting guidelines exist for the SPF team. However, we verified that the team has access to sector-specific guidelines issued by external agencies such as S&P, Moody’s and Fitch. We were informed that the underwriting team uses the external agencies guidance documents as reference, where

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.

necessary. Further, our sample testing of six underwriting files did not result in any significant observations. Management is in the process implementing a new SPF risk rating model and has developed an action plan to leverage the new risk rating methodology in documenting new SPF underwriting guidelines.

Rating of Audit Finding - Moderate²

Action Owner – Sven List, (Vice-President, Structured & Project Finance)

Due Dates - Q4 2017.

Conclusion

The audit finding and action plan has been communicated to and agreed by management, who has developed an action plan that is scheduled for implementation no later Q4 2017. We would like to thank management for their support throughout the audit.

²The 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.