Chapter 2
Department of Business New Brunswick
Financial Assistance to Industry

Contents

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Background

2.1 In 1998 we audited the Financial Assistance to Business Program in the Department of Economic Development and Tourism. Results of the audit were presented in the 1998 Report of the Auditor General.

2.2 We made 29 recommendations about the Financial Assistance to Business Program in our 1998 Report. Appendix A gives a summary of our 1998 audit findings.

2.3 We followed up on our 1998 recommendations in our Reports of 2000, 2001 and 2002. By 2002 eight of our 29 recommendations had been implemented. At the time of our Report in the fall of 2002 the Department indicated that it would be implementing an additional eight recommendations later that year. A further four recommendations were to be partially implemented around the same time. As has been our practice for a number of years, our follow-up work ended with the 2002 review, so we did not carry out any more work to see if more than eight recommendations were indeed implemented after that 2002 Report.

2.4 In 2008 we decided to re-visit this program to assess whether Business New Brunswick (BNB) has adequate procedures in place to measure and report on the effectiveness of the financial assistance it provides to industry. Given our limited resources we re-audited only two of the original objectives: monitoring and reporting. Furthermore, we only examined the Financial Assistance to Industry Program (FAIP).

2.5 FAIP is by far the largest financial assistance program managed by Business New Brunswick to support the development and maintenance of key economic sectors in the Province. According to the BNB website at the time of our audit, FAIP:

> *provides funding for capital expenditures and working capital to enable the establishment, expansion or maintenance of new or existing manufacturing or processing industries, selected commercial service firms (business to business with focus on export activity or import displacement), tourism operations, and information technology companies.*

2.6 The financial assistance is delivered to clients in three ways:

- loan guarantees;
- direct loans; and
- strategic assistance in the form of forgivable loans.

2.7 During the fiscal year 2006-2007, there were 281 active accounts under FAIP, which represented 42% of a total of 666 accounts in Business New Brunswick's portfolio. The total outstanding balance of these 281 accounts was approximately $372.4 million or 84% of the total outstanding balance of $445.5 million. Exhibit 2.1 below lists the outstanding balances by categories.

Exhibit 2.1 Types of financial assistance – fiscal year ending March 31, 2007

	($ millions)					
	Loan guarantee	**Direct loan**	**Forgivable loan**	**Equity investment**	**Lease**	**Total**
FAIP	141.5	151.5	59	20.4	0	372.4
Total portfolio	159.9	205.2	59.5	20.4	0.6	445.5
FAIP as a % of total	88.5%	73.8%	99.2%	100.0%	0.0%	83.6%

Source: department annual reports

2.8 Exhibit 2.2 shows the total number of applications evaluated and approved over the fiscal years from 2002-03 to 2006-07.

Exhibit 2.2 Number of applications evaluated and approved (2002-03 to 2006-07)

Fiscal year	Applications evaluated	Applications approved	
		Number of cases	$ (millions)
2002-03	172	97	185.9
2003-04	167	51	117.0
2004-05	115	59	51.8
2005-06	119	41	104.3
2006-07	181	67	106.0

Source: department annual reports

2.9 Exhibit 2.3 presents the cash outlays for the same five fiscal years.

Exhibit 2.3 Cash outlays for 2002-03 to 2006-07

	Cash outlays under FAIP 2002-03 to 2006-07 ($)				
	2002-03	2003-04	2004-05	2005-06	2006-07
New loans	19,495,348	13,336,871	18,224,231	30,001,560	26,674,545
Loan recoveries	(12,603,186)	(25,811,212)	(11,147,139)	(25,490,847)	(6,102,135)
Payouts on guarantees	5,231,823	2,486,451	13,406,903	2,641,836	7,108,484
Recoveries of payouts on guarantees	(96,948)	(81,660)	(116,942)	(194,872)	(160,995)
Forgivable loans	15,213,770	10,267,006	11,931,560	8,644,884	23,412,142
Total net cash outlays	27,240,808	197,456	32,298,612	15,602,560	50,932,041

Source: Business New Brunswick

2.10 Currently, FAIP is administered by the Business Financial Support Division at Business New Brunswick.

Scope

2.11 Our audit objective was:

To assess whether Business New Brunswick has adequate procedures in place to measure and report on the effectiveness of the financial assistance it provides to industry.

2.12 Our audit was performed in accordance with standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

2.13 During the course of this audit, we selected 40 accounts to test. The sample was randomly chosen from 200 accounts where financial assistance has been granted to departmental clients under FAIP over the four fiscal years from 2002/03 to 2005/06. We chose this time period for two main reasons. First, we believe that the Department would have had sufficient time to have implemented the recommendations published in our 1998 Report. Secondly, when we did our testing in 2008, we felt that assistance issued after fiscal year 2005/06 would not have been in place long enough for us to be able to adequately test the Department's monitoring activities. Among the 40 accounts selected, there were 8 direct loans, 16 loan guarantees, and 16 forgivable loans. From this 40 item sample, we actually examined 38 accounts. This is because one account was "cancelled" and another one was withdrawn by the applicant. The cancelled account was a loan guarantee, and the withdrawn account was a direct loan.

2.14 Because of the public attention in two large and widely publicized financial assistance situations, we also reviewed the files of AV Nackawic and Atlantic Yarns as special items. Appendix B covers these two items.

2.15 Our testing of sample items included:

- confirming that data is being received from clients pursuant to the terms and conditions in the letter of offer, and that any omissions are followed up;
- determining the process used to verify the information provided by assistance clients;
- determining if there is any evidence that the data received from clients has been verified. In particular, we tested to see if data had been verified prior to forgiving a loan; and
- assessing whether the data being captured by the Department is sufficient to allow the Department to report against its own targets.

2.16 We also reviewed Business New Brunswick's Strategic Plan titled *Toward Self-Sufficiency "The First Steps" 2007-2011* and the Department's annual reports of recent years. The purpose of this was to allow us to assess the specific performance expectations set for the Department as a whole and the FAIP specifically.

Results in brief and conclusion

2.17 Our conclusions for each audit area are summarized in the second column of Exhibit 2.4 below. The criteria shown in the first column established the framework for our audit. The criteria were agreed to both by representatives of the Department and our Office.

Exhibit 2.4 Summary of audit findings and recommendations

Audit area and criterion	Summary of conclusions
1. Objectives and targeted results -BNB should ensure that the objectives and the targeted results of the FAIP have been clearly defined and linked to the overall performance expectations set for the Department.	The targeted results of FAIP have been clearly defined and linked to the overall performance targets set for the Department.
2. Reporting from FAIP clients - BNB should receive sufficient reporting from FAIP clients to allow it to assess, on a timely basis, whether clients have complied with all the terms and conditions associated with assistance provided.	The Department was able to identify outstanding items and follow up with clients through the monitoring program. Those items were normally obtained subsequently. However, the Department did not receive sufficient reporting on a timely basis, despite the efforts being made by the Department.
3. Verification of client information - BNB should review the information provided by assistance clients and verify the information where concerns exist as to its accuracy.	The Department did act when the accuracy of information received was questionable, but the methods used to verify this information were inconsistent and not well documented.
4. Loan forgiveness information - BNB should ensure that information provided by assistance clients pursuant to requests for loan forgiveness is verified prior to forgiving loans.	We found evidence of some information being verified, but there are no written policies and procedures to ensure the verification is being conducted consistently and properly.
5. Mitigation of potential loss - When it becomes evident that the Province is at risk of loss for a particular assistance file, BNB should take appropriate mitigation steps.	The analyses performed by the Department are not well documented. Therefore, it is very difficult to determine the sufficiency of analyses performed and the appropriateness of the mitigation steps taken.
Reporting on effectiveness: 6. BNB should capture sufficient data to allow it to report on the effectiveness of the FAIP in achieving its objectives.	We believe that the Department captures a significant amount of data regarding FAIP. This would give the Department the ability to report how FAIP is contributing to the departmental objectives.
7. BNB should regularly provide the Legislative Assembly with accurate, timely and understandable information on the continued relevance of the FAIP, and the effectiveness of the program in achieving its objectives.	The Department is not reporting progress towards the achievement of the objectives of FAIP.

Conclusion

2.18 We have seen improvements in Business New Brunswick's monitoring of financial assistance since 1998, particularly the areas of setting objectives and targeted results for FAIP as well as capturing data and documenting its monitoring activities. We have also seen some internal documents providing relevant information which could be used to evaluate the effectiveness of FAIP. However, we still feel that the level of monitoring done by the Department is not sufficient, and clearly documented policies and procedures either do not exist or are not consistently applied. The Department also needs to improve the reporting of information about the effectiveness of the FAIP in its annual reports.

Objectives and targeted results

2.19 Our first criterion was:

> *BNB should ensure that the objectives and the targeted results of the Financial Assistance to Industry Program (FAIP) have been clearly defined and linked to the overall performance expectations set for the Department.*

2.20 We believe it is important for the Department to have clearly defined objectives for the FAIP and to have measurable targeted results, both of which should be relevant to the overall objective of the Department. This would allow the public to evaluate the program qualitatively and quantitatively.

2.21 We reviewed Business New Brunswick's strategic plan *Toward Self-Sufficiency "The First Steps" 2007-2011*. The goals and strategies of the Department as a whole were highlighted in the plan. The goals are:

- to increase New Brunswick's productivity and competitiveness;
- to increase sustainable and high-value jobs in New Brunswick; and
- to promote a more competitive business-friendly environment in New Brunswick.

2.22 The strategies are:

- aggressive investment attraction;
- business retention and expansion; and
- cluster development.

2.23 The Department also discloses the "purpose of FAIP" in its website as follows:

> *The purpose of the assistance is to provide adequate funding for capital expenditures and working capital to enable the establishment, expansion, or maintenance of those eligible industries.*

2.24 We believe the objectives of FAIP have been clearly defined. They are relevant to the Department's goals and strategies.

2.25 The Department has established some annual targets to measure whether it is achieving its goals and objectives. These targets include: creating 3,000 new jobs annually, 2,000 of which would have an average salary of $30,000; annually maintaining 2,500 jobs; and annually achieving a "leveraged capital investment threshold" of $100 million.

2.26 The strategic plan says that of the 3,000 new jobs to be created annually, 2,000 would be through investment attraction and 1,000 would be through business retention and expansion. We could not, however, determine how FAIP integrates into the strategic plan. The strategic plan does not identify specific targets for FAIP.

2.27 When we reviewed the Department's 2007-2008 annual report, we found the following reference to FAIP:

> *The Business Financial Support Division supports Business New Brunswick's three strategic priorities of Investment Attraction, Business Retention and Expansion, and Cluster Development through the delivery of loan guarantees, direct loans and strategic assistance. The Department's financial assistance programs include the* Financial Assistance to Industry Program (FAIP), *the* Entrepreneur Program, NB Growth Program, *and industry specific financial support to the commercial fishery, aquaculture and agriculture sectors.*

2.28 We also reviewed the work plans of the Financial Programs and Business Financial Support Branches. FAIP is mainly managed by the Financial Programs Branch. Accounts under FAIP can be allocated to the other Branch, depending on the work load. These internal departmental documents established 3 measurable targets: new jobs to be created, jobs to be maintained, and amount of capital investment to be leveraged. These targets of the Branches can be clearly linked to the overall targets of the Department. The target date of achieving the targets is also listed in the plans.

2.29 Since FAIP is a significant part of the Financial Program Branch's responsibilities, the measurable targets of the Branch can be considered as those of FAIP. However the Department does not report publicly the results of FAIP against its three measurable areas, job creation, job maintenance and leveraged capital investment.

2.30 We have concluded that this criterion is met since the targeted results of FAIP have been clearly defined and linked to the overall performance targets set for the Department.

Recommendation

2.31 We recommended the Department establish additional measurable targets for FAIP to allow it to evaluate FAIP from different perspectives.

2.32 The Department should also consider cost-benefit analysis as a tool to assess whether or not the costs of FAIP can be justified by the outcomes and impacts. This type of analysis measures both inputs and outputs in monetary terms and could be related to the targets established.

2.33 The following measurable targets could be established to facilitate the cost-benefit analysis:

- actual number of jobs created;
- actual number of jobs created that still exist in years after the financial assistance has been delivered;
- gross cost of each job actually created;
- actual return achieved; and
- comparison of the cost of jobs created to the return on those jobs.

2.34 We believe that the measurable annual target should be focused on actual jobs and returns, not just committed jobs and estimated returns.

Reporting from FAIP clients

2.35 Our second criterion was:

BNB should receive sufficient reporting from FAIP clients to allow it to assess, on a timely basis, whether clients have complied with all the terms and conditions associated with assistance provided.

2.36 The Department should ensure that assistance recipients are submitting the information required by the letters of offer. Receiving this information on a timely basis is critical in order for the Department to monitor the assistance it has provided. A letter of offer may, for example, require the assistance recipient to submit annual audited financial statements and quarterly reports on employment levels.

2.37 The monitoring group conducts compliance reviews annually. The compliance review officers verify if and when the Department received the information required by the letter of offer. A compliance report is drafted to indicate whether the file is in compliance and, if it is not, what action is needed to bring the file into compliance. A draft compliance report is sent to the responsible project executive. After 30 days, the compliance review officer contacts the project executive to finalize the compliance report. If documents are still missing, a letter requesting missing documents will be sent directly to the assistance recipient by the monitoring group.

2.38 The policies and procedures for compliance review, including follow-up, are well documented and followed by the compliance review officers. Compliance reviews and follow-ups were performed on all of the 38 accounts included in our sample. We also saw evidence indicating that documents requested as part of the compliance reviews and follow-ups were received; however, not all information has been received on a timely basis.

2.39 We reviewed the compliance review reports. The Department's monitoring group had identified at the time of their file reviews that:

- 11 files out of our sample of 38 accounts had complete information;
- 16 files were not in compliance with all the requirements; and
- the other 11 files were not applicable due to various reasons, such as the case being transferred to another program, no funds being advanced, and the company rejected the offer.

2.40 The most common missing document in the 16 files which were not in compliance at the time of the monitoring group's review was annual audited financial statements. Although the Department was able to obtain them eventually, in most cases they were at least a year late. In one case, the compliance review was conducted in December 2006. At that point, the latest annual financial statements received were for the year ended 31 December 2001. In another case, there were only unaudited financial statements on file, although audited ones were required by the letter of offer. Two files were not in compliance at the time of the monitoring group's review because the employment reports were not submitted on time.

2.41 We have concerns about two files which were identified by the Department's monitoring group as being in compliance. In one case, the compliance review was finalized in July 2007. The last set of financial statements received was for the year ended 31 January 2005. The monitoring officer commented "client Co will not provide BNB with copies of financial information". The officer noted, however, in another section of the compliance report that "the project executive has reviewed the latest financial information at client Co's premises and is comfortable that restrictions are being followed". Therefore, the file was considered by the monitoring group to be in compliance. One may question why the client did not submit the latest financial information when it was available. In the other case, the monitoring officer commented "according to the project executive, this was a grant and there were no conditions or restrictions related to the financial assistance". The file was considered by the monitoring group to be in compliance as no information was required. However, the letter of offer clearly stated there were conditions and restrictions.

2.42 We have concluded that this criterion was partially met. The Department was able to identify outstanding items and follow up with clients through the monitoring program. Those items were normally obtained subsequent to the monitoring group's review. However, the Department did not always receive sufficient information on a timely basis, despite the efforts being made by the Department. We believe the incomplete and delayed reporting could restrain the Department's ability to closely monitor the status of its clients and to provide timely intervention.

Recommendation

2.43 We recommended the Department investigate why required documents are not being submitted on a timely basis and seek alternative ways to obtain timely information from its clients.

2.44 Each project executive could be required to prepare a quarterly update on any files that they know are not in compliance with the terms of the letter of offer.

2.45 The Department could also determine which types of reporting from assistance recipients are critical in terms of monitoring financial status.

Verification of client information

2.46 Our third criterion was:

> *BNB should review the information provided by assistance clients and verify the information where concerns exist as to its accuracy.*

2.47 The information provided by assistance recipients to the Department must be accurate in order to allow the Department to adequately monitor its assistance.

2.48 Audited financial statements are normally required by the Department. In some cases, financial statements with review level of assurance are acceptable with the Deputy Minister's consent.

2.49 In the files we examined, there was evidence indicating that the non-audited information provided had been verified, when the Department thought the accuracy of information was questionable. For example, we found in one case that the Department challenged the financial assistance recipient's calculation of number of "full time equivalent" jobs created. However, there is no documented process or approach on how to identify potentially inaccurate information. In one case, the financial assistance recipient kept submitting financial statements with review level of assurance, although audited financial statements were required. Annual budget and cash flow forecasts were required to be submitted, but none were on file. This should have raised concerns in the Department about the accuracy and adequacy of information provided. However we did not find any documentation of verification procedures performed.

2.50 Furthermore, the Department does not have written policies and procedures on how to verify the accuracy of information when concerns exist. We were told that the project executives would perform certain due diligence procedures such as a site visit to verify the information provided. But a site visit is not always documented. It is difficult for us to determine whether the procedures indeed were performed and what the conclusions were on the accuracy of questionable data. We noted inconsistent practices among project executives.

2.51 Without policies and procedures to promote consistency, the Department could face an increased risk of questionable accounts not being identified and information not being verified properly.

2.52 We have concluded that this criterion was partially met. The Department did act in some cases when the accuracy of information received was questionable, but the methods used to verify this information were inconsistent and not well documented.

Recommendation

2.53 We recommended the Department establish policies and procedures with respect to verifying clients' financial information other than their audited financial statements.

2.54 Any verification or analysis performed by the Department should be documented and that documentation should be maintained on file.

Loan forgiveness information

2.55 Our fourth criterion was:

> *BNB should ensure that information provided by assistance clients pursuant to requests for loan forgiveness is verified prior to forgiving loans.*

2.56 We believe it is important for the Department to verify the information provided by assistance recipients in order to determine whether the clients meet the forgiveness criteria. This is essential to safeguard the Province's financial position and to ensure the original objectives are achieved.

2.57 Most forgivable loans include forgiveness incentives based on the number of jobs created or maintained, i.e. the loans would be forgiven as long as the companies can create or maintain a certain number of jobs over a specified period of time.

2.58 Normally the assistance recipients submit payroll data as evidence of jobs created or maintained. In 14 out of 16 sample items of forgivable loans we tested, the Department was successful in obtaining the payroll information on a timely basis.

2.59 We held discussions with various staff members of the Department. Based on these discussions, it appears that the approaches and procedures used to verify payroll data are not always the same. Some project executives told us they conduct site visits, randomly pick payroll data to test, and reconcile the payroll data to a T4 Summary submitted to Canada Revenue Agency. Others told us they reconcile the payroll report received from the client to T4 Summary information on an annual basis. Some project executives just trust that the payroll report provided was accurate as long as it was signed by a professional accountant. Basically, it is up to the individual project executive to decide the level of verification, based on the project executive's experience and assessment of the quality and credentials of the financial assistance recipient. Regardless of the method described, we found little documentary evidence in our sample items of the procedures conducted. We did find in one account that the Department questioned the calculation of "full-time equivalent" jobs submitted by the financial assistance recipient. The Department issued a certificate to only partially forgive the loan.

2.60 There are no departmental policies and procedures in place to guide project executives on how to verify the information provided by clients. This means there can be inconsistent practices used to determine the forgiveness, with the risk that some loans could be forgiven that should not be.

2.61 We have concluded that this criterion was partially met. While in some cases we found evidence of information being verified, there are no written policies and procedures to ensure the verification is being conducted consistently and properly.

Recommendation

2.62 We recommended the Department establish policies and procedures on how to verify information provided by assistance clients prior to forgiving loans.

Mitigation of potential loss

2.63 Our fifth criterion was:

> *When it becomes evident that the Province is at risk of loss for a particular assistance file, BNB should take appropriate mitigation steps.*

2.64 We believe that proactively managing the entire financial assistance portfolio is key for the Department to protect the Province's investments. The Department should identify assistance that is at risk as early as possible through effective use of data analysis. This is necessary in order to reduce the risk of potential loss and keep financial assistance recipients in operation.

2.65 Prior to 2007, the Department's monitoring group did some financial analysis on the financial status of each of the Department's assistance recipients on an annual basis. We found that monitoring officers had completed a brief analysis of financial status annually and documented it in a compliance report for all 38 of the accounts we tested. When doing such a financial analysis, the monitoring officer would assess such things as whether sales declined, whether income from operations declined, whether working capital deficiencies existed, and any changes in shareholders' equity. Such information is useful in evaluating whether the risk position of the assistance recipient has changed since the original approval of assistance.

2.66 Recently, the Department decided that the monitoring group would no longer assess the financial condition of its assistance clients. That responsibility was assigned to the individual project executives. We were told that this change was made because the project executives have a better understanding of the operations of the companies. We believe this is a step backwards because it means the compliance report will not include information regarding the financial position of a company which could be used to determine whether a particular assistance file is at risk of loss.

2.67 According to the Department, project executives continue to conduct some monitoring activities regarding the financial status of the companies. They would review the information obtained from the companies quarterly and discuss it with the Department's management. For example, sales would be compared to the prior period and the company's forecast. Bank reports would be reviewed to determine the company's cash position and whether there are delinquent loans. The Department would take mitigation steps if a particular file is determined to be at risk of potential loss. Some other monitoring activities include site visits and phone discussions with the companies to get current information. But a site visit report is not always prepared and documented.

2.68 The most typical mitigation steps at BNB include providing more financial assistance and amending the terms of the existing financial assistance including extension of the maturity period or postponement of principal or interest payments. Other steps the Department may take are negotiating with other lenders of the company and helping the company find funding from other federal or provincial agencies. The Department presented us with a few cases in which the accounts were identified as high risk of potential loss.

Mitigation steps were taken by the Department to save the companies.

2.69 Given the fact that most of the financial assistance granted is relatively risky compared with typical commercial lending, we would expect the Department to have a formal process to define which types of financial or operational analysis should be performed to identify problem accounts and what loss mitigation steps should be taken. For example, quantitative data analysis such as ratio analysis is a very common practice adopted by many commercial lenders to identify borrowers with potential financial problems. Although the financial assistance provided by the Department is different from typical commercial lending in many ways, the methods to identify risks of potential loss should not be significantly different.

2.70 Risk segmentation can also be used to determine the specific risk level of an account within the portfolio. Accounts with similar risk characteristics can be placed in appropriate segments, such as high, medium and low risk categories, to direct the efforts of risk mitigation.

2.71 The Department does not have formal processes and procedures to guide project executives on which types of financial or operational analysis should be done in the monitoring stage. It's up to individual project executives to decide what financial and operational data to check and what types of analysis to perform. The lack of consistency may increase the risk of not identifying an assistance file with potential problems at the earliest point possible.

2.72 Furthermore, as we mentioned earlier, the Department is not always able to get financial reporting from the financial assistance recipients on a timely basis. Outdated financial information may further limit the Department's ability to identify the risk of potential loss at its earliest point.

2.73 Our testing illustrates our concerns. We found that 15 of the 38 companies in our sample received multiple financial assistance. 10 out of the 15 companies are currently out of business: 5 companies were bankrupt and 5 companies ceased operations in New Brunswick or are in the process of liquidation. As a result, the Department incurred $6.4 million in bad debts and up to $5.8 million in guarantee payouts for these ten companies.

2.74 We can not conclude on this criterion. The analyses performed by the Department are not well documented. Therefore, it is very difficult to determine the sufficiency of analyses performed and the appropriateness of the mitigation steps taken.

Recommendation

2.75 We recommended BNB establish policies and procedures regarding which types of financial analysis should be performed to identify risk of potential loss and which types of mitigation steps should be taken based on the risks identified.

2.76 The Department will have to decide whether the monitoring of financial status should be done by the monitoring group or the project executives. We believe, however, that monitoring is not compatible with the duties of project executives. Therefore, the monitoring is more likely to be completed if it is not added on to the other work that the project executives have to do in preparing analyses and other decision-making tasks required by the approval process.

Reporting on effectiveness

2.77 Our final two criteria address the importance of the Department's capturing sufficient information to allow it to report on the FAIP in a timely and transparent manner.

2.78 Our sixth criterion was:

> *BNB should capture sufficient data to allow it to report on the effectiveness of the FAIP in achieving its objectives.*

2.79 We believe that, in order to assess the effectiveness of the program, the Department needs to have sufficient data.

2.80 During the testing stage of our audit, the Department provided us a spreadsheet which listed all the applications approved under FAIP from the fiscal year 2002/2003 to 2005/2006. It contained important data for every approved financial assistance application, such as type of financial assistance, approved amount, funds advanced, leveraged capital investments, and number of jobs committed. This spreadsheet was generated from an internally developed information system which is managed by the monitoring group.

2.81 This system is not only recording the number of jobs committed by the applicants, but also tracking the actual jobs created or maintained.

2.82 Every quarter the monitoring group adds all the new approvals with committed job numbers in the information system. Staff in the monitoring group then sends a template to the project executives responsible for the accounts with a request to fill in the necessary data including current number of jobs at the applicants and generally gives them a deadline.

2.83 As the project executives send back their information, monitoring staff inputs the information into the Corporate Information System. If project executives are not providing the information in a timely fashion, reminders and other follow-ups are sent out. Project executives are usually able to provide updated information the next quarter.

2.84 If a project executive is not able to obtain current job information about an account in a particular quarter, or the monitoring group may have some concern with an aspect of it, the job numbers would remain the same as the previous quarter, provided the information obtained in the past has been relatively stable and consistent.

2.85 To accurately track jobs created, staff in the monitoring group would usually follow up with the project executive to ascertain that the new figure is correct and to obtain explanations about large variances from one quarter to another.

2.86 The monitoring group conducts a final count of actual jobs created when the project matures and is completed. The actual jobs created or maintained would be compared with the jobs that must be created and maintained for a specific length of time specified in the legal agreements.

2.87 We believe the Department captures a significant amount of data regarding FAIP. This would give the Department the ability to report how FAIP is contributing to the departmental objectives.

2.88 Therefore, we concluded that this criterion was met.

2.89 Our seventh criterion was:

BNB should regularly provide the Legislative Assembly with accurate, timely and understandable information on the continued relevance of the FAIP, and the effectiveness of the program in achieving its objectives.

2.90 We believe that reporting on the effectiveness of the FAIP is an important monitoring function.

2.91 The Department reports in its annual reports the number and dollar amount of applications approved in a fiscal year, the number of active accounts, and the total outstanding balance for the FAIP. The information is presented separately by category: loan guarantee, direct loan and strategic assistance.

2.92 The Department has not tied its annual reporting about FAIP to the overall departmental objectives. As we reported earlier, the Department has annual targets for jobs created, jobs maintained and leveraged capital investments. The annual report needs to include information about FAIP's contribution to the achievement of the Department's targets.

2.93 We have concluded that the seventh criterion was not met. The Department is not reporting progress towards the achievement of the program objectives to the Legislative Assembly.

Recommendation

2.94 We recommended the Department report to the Legislative Assembly on the success of FAIP in achieving the Department's targets.

Other observations

2.95 In the past, BNB calculated a payback period as part of its assessment of a request for financial assistance from a company. The calculation was based on three factors:

- potential risk that the proposed project will not produce a full return;
- expected annual incremental payroll; and
- estimated rate of provincial personal income taxes.

2.96 From this, an annual amount of expected incremental personal income taxes was calculated. The amount of the incremental annual income tax was compared to the amount of assistance required, resulting in an estimate of the number of years it would take the Province to recover the assistance provided through the incremental personal income taxes – the payback period.

2.97 When considering the potential risk that the proposed project will not produce a full return, the Department conducted an evaluation of the applicants' risks associated with technology, materials, marketing, competition, management, and financial condition. The Department used standard procedures and forms when evaluating the request for assistance including the calculation of the payback period. Evaluation forms were properly completed and approved for all 38 of the accounts we tested.

2.98 Exhibit 2.5 provides an example of the payback calculation which the Department used to conduct for three different types of loans. Because forgivable loans are paid out in full, no risk factor is attached to them.

Exhibit 2.5 Example of a payback calculation

Assistance							
Loan type	Amount ($000's)	Payout risk	Potential payout amount ($000's)	Incremental payroll ($000's)	Tax rate	Estimated annual return ($000's)	Payback period (years)
Guarantee	400	30%	120	1,000	10%	100	1.2
Forgivable	5,500	N/A	5,500	29,100	10%	2,900	1.9
Direct	10,000	50%	5,000	18,000	10%	1,800	2.8

2.99 In this table, the risk of a payout is multiplied by the amount of assistance approved, to determine the potential amount of payout for the Department. The estimated incremental payroll is multiplied by the assumed tax rate to arrive at an estimated annual return of tax revenue to the Province. The potential payout amount is then divided by the estimated annual return to arrive at the payback period, the amount of time it will take the Province to recover its estimated payout through increased tax revenue.

2.100 The Department continues to use the payback calculation as one of the key elements to determine whether forgivable loans should be offered, while it stopped using the above model in 2004 to calculate a payback period for direct loans and loan guarantees. The Department has not established any similar quantitative benchmarks in the process of assessing a request for a direct loan or loan guarantee to support the decision of whether or not a direct loan or a loan guarantee should be offered.

2.101 We believe it is important to monitor the achievement of the expected payback period for forgivable loans. This would allow the Department to assess whether their original financial return estimates were valid, something that would be useful in making estimates for future projects. We also believe it is useful to establish similar benchmarks for direct loans and loan guarantees. The quantitative measurements can help the Department not only in the decision-making process but also in monitoring effectively the actual results against the outcomes anticipated by the Department and reporting the performance of FAIP to the public.

2.102 The monitoring group is not collecting any information to verify whether the increase in payroll that the original payback calculation assumed would occur had in fact occurred. They are also not collecting any information about whether income tax rates had changed since the original assistance was granted.

2.103 Without information about the actual amount of incremental payroll generated, it is not possible for the Department to properly assess whether the original payback estimate remains achievable or was achieved. Nor is it possible to assess whether the original payback model was valid or to assess whether the assistance that was granted resulted in the outcomes anticipated by the Department.

2.104 Monitoring the achievement of the intended payback period, including the amount of incremental payroll generated, would also help the Department monitor the number and value of jobs created through the financial assistance that was granted. This would allow the Department to report its progress in achieving the key performance indicator contained in its strategic plan about the number of jobs created and maintained.

Recommendation

2.105 We recommended BNB put in place a monitoring process that directly assesses each forgivable loan recipient's progress compared to the original payback calculation. This assessment should look at each of the three components of the original payback calculation: the risk factor, the estimated amount of incremental payroll and the income tax rate.

Departmental response to our audit

2.106 The Department provided the following response to our report conclusions and recommendations:

> *Please be assured that your office's comments are appreciated by this Department as we continually endeavor to improve on current practices. It is felt that a number of the recommendations made could serve to improve the administration of our financial assistance programs. However, we feel that certain conclusions are unfounded and associated recommendations would not be*

constructive. Our response to your office's conclusions on the seven audit criteria and the overall audit is therefore summarized below.

Re: Audit Criterion 1:

Department's response to conclusion reached:

The Department concurs with this conclusion.

Department's response to recommendations made:

Annual performance targets now established by the Department pertain to forecasted results associated with approvals made within that year. Measureable annual targets as suggested above relating to actual job creation associated with approvals within the year cannot be reported on within the year as actual job creation typically occurs over subsequent years. In any case, establishment of long term targets to assist in program evaluation is currently not being pursued by the Department as it will be undertaking an evaluation of its financial assistance programs with the Office of the Comptroller in the very near future. The review will explore the actual costs and benefits associated with approvals over the previous nine years.

Re: Audit Criterion 2:

Department's response to conclusion reached:

[Paragraph 2.38] *noted that "Compliance reviews and follow-ups were performed on all of the 38 accounts included in our sample". Furthermore,* [paragraph 2.42] *notes that "The Department was able to identify outstanding items and follow up with clients through the monitoring program. Those items were normally obtained subsequent to the monitoring group's review". It is clear that the Department identified and followed-up on all items as required, and that all items were eventually provided. The Department obviously has no control over when items are eventually provided by the company, and its only recourse would be to make a demand on its loans or cancel its guarantees. However, forcing company closure due to* *a lack of reporting is not felt to be a realistic option. The audit conclusion "the Department did not receive sufficient reporting on a timely basis" places this Department in a bad light, and we feel the conclusion as worded to be extremely unfair given our considerable monitoring and follow-up efforts.*

Department's response to recommendations made:

No investigation is required to determine why clients fail to submit documents on a timely basis. Clients know that the Province is not likely to demand on loans or cancel guarantees (thereby resulting in business closures) due to a lack of reporting.

However, the Department will explore amendments to the Economic Development Act *to enable increases in interest rates or guarantee fees for non-compliant accounts. This may motivate compliance. As well, the monitoring group will be implementing a quarterly non-compliance monitoring report by officer to enable improved monitoring.*

Re: Audit Criterion 3:

Department's response to conclusion reached:

The department will endeavor to ensure that staff better document methods used and actions undertaken to investigate information where concerns exist as to its accuracy.

Department's response to Recommendations made:

Given the magnitude and variety of information provided, it would be extremely difficult to develop specific policies and procedures to be followed in addressing every conceivable instance where concerns exist as to the accuracy of any information provided. The department feels that such a policy would be so broad as to render its effectiveness questionable. Project Executives consist of experienced professional staff with the necessary skills to determine what verification methods may be required. Consequently, the department does not intend to fully *implement this recommendation at this time, but will take steps to ensure that staff better document methods and actions undertaken to investigate questionable information.*

Re: Audit Criterion 4:

Department's response to conclusion reached:

The statement "We found evidence of some information being verified" implies very little information was verified, whereas required information necessary to earn forgiveness was in fact on file or in a database and was reviewed prior to any forgiveness being granted. However, the department acknowledges that summary memos outlining the steps undertaken by officers to review and verify the information provided and to justify the rationale for forgiveness decisions were not in all cases on file.

Department's response to Recommendations made:

The department will develop policies and procedures relating to the review and verification by staff of information provided by clients in conjunction with loan forgiveness, and will ensure that memos are on file summarizing the forgiveness rationale and steps taken by officers in reviewing and verifying information on all future loan forgiveness transactions.

Re: Audit Criterion 5:

Department's response to conclusion reached:

The Department takes exception to the following underlined portion of the statement "The analyses performed by the Department <u>are not sufficient</u> or well documented". The Department acknowledges that a summary of the information analyses undertaken by staff in conjunction with their account monitoring duties is not always well documented in the file. However, the Department disagrees with the statement that any analysis undertaken is not sufficient. Furthermore, the logic of the above-noted conclusion is questionable as it would be impossible to comment on the quality of analysis *undertaken if it is not well documented. If no comment can be made as to the appropriateness of mitigation steps undertaken because analysis is not well documented, how can comment be made of on the quality of the analysis itself?*

Department's response to Recommendations made:

Note that project executives are professional staff with years of experience in commercial lending or corporate finance. The project executives in fact review all information provided as part of the borrower's compliance requirements and, through discussions with their respective managers, flag issues and bring forward recommendations for mitigation steps as appropriate. Any agreed upon mitigation steps requiring amendments to the current assistance authority established for that account are reviewed by the Department's senior Project Review Committee and the New Brunswick Industrial Development Board, and if necessary by Board of Management and Cabinet. Such recommendations and related analyses are well documented and are on file. However (and as noted above), analyses in conjunction with account monitoring relative to accounts requiring no adjustments to current assistance authority could generally be better documented in the file.

The Department feels the need for policies to provide procedural guidance to project executives detailing the type and method of analysis to be undertaken is not required given their level of experience. As well, it would be extremely difficult to pre-define within a policy what specific mitigation steps should be undertaken in any instance. Officers have the skill sets and latitude to research, formulate and bring forward mitigation recommendations for management's review as required.

However, the Department believes the following policy would be useful: i) that a memo summarizing the information analyses undertaken in conjunction with account monitoring activities be placed on the file for all future reviews, ii) that the minimum requirements for such a review be specified in terms of issues and critical information to be reviewed, and iii) that any recommended *mitigation steps be summarized in the memo as appropriate.*

The Department does not concur with the recommendation that the monitoring group (rather than the project executives) be responsible for account monitoring as outlined in [paragraph 2.76]. *The monitoring function was reassigned from the project executives to the monitoring group some time ago in hopes of improving the monitoring function. It was subsequently determined that the project executives had better in-depth knowledge of the file and were better able to identify issues. The result was this account monitoring function being reassigned back to the project executives. Accordingly, the Department will not be acting on this recommendation, but will ensure analysis undertaken by project executives is better documented in the file.*

Re: Audit Criterion 6:

Department's response to conclusion reached:

The department concurs with the conclusion.

Re: Audit Criterion 7:

Department's response to conclusion reached:

The Department disagrees with this conclusion. [Paragraph 2.24] *acknowledges that "We believe the objectives of the FAIP are clearly defined" and that achievement is measured by the Department in terms of forecasted jobs created and maintained and forecasted capital leveraged associated with FAIP approvals. The number of forecasted jobs created and maintained and forecasted capital leveraged in conjunction with FAIP approvals is clearly reported by the Department in its Annual Report (as demonstrated on page 7 of its 2008-2009 Annual Report). The Department therefore feels that it has reported on its progress in achieving FAIP objectives.*

Department's response to recommendations made:

The Department has opted not to include FAIP targets in its annual report. However, its annual report is not produced for the sole purpose of reporting to the Legislative Assembly, nor is it the sole method used for reporting. The Department appears before and reports to the Legislative Assembly at the Public Accounts Committee and at Main Estimates, and provides any information required by the Legislative Assembly at that time, including information on FAIP targets if so requested.

As mentioned previously, it is impossible to comment in the annual report on actual jobs created or maintained and capital leveraged in conjunction with FAIP approvals within the year as actual results typically occur in subsequent years.

Re: Other Observations:

Department's response to recommendations made:

The above recommendation mistakenly implies that a "risk factor" forms part of the Department's forgivable loan payback calculations. As was frequently explained in discussions with OAG staff, risk factor does not form part of the Department's forgivable loan payback calculations as this assistance is expensed when disbursed. The forgivable loan payback calculation only estimates the time required for the assistance cost to be offset by incremental tax revenues (assuming the company survives), and this calculation was only undertaken to enable some measure of assistance level consistency between accounts.

The comments in the report and the above recommendation implies that such a monitoring process is not in place, whereas it actually is in place and is the responsibility of the assigned project executives (not the monitoring group). Forgivable loan assistance is typically approved for amounts and terms in keeping with the associated payback calculation. For instance, a forgivable loan provided for job creation would include forgiveness conditions premised on the creation and maintenance of jobs and salary levels for a period as defined in the payback calculation. Project executives are then required to review *the actual results (actual job numbers and payroll attained, etc.) at the end of the required job maintenance period. Loans not forgiven are to be repaid, and repayment would obviously indicate that originally anticipated payback levels were not attained (however there would be no cost to the province if the assistance is repaid). Conversely, accounts meeting forgiveness requirements would indicate attainment of the payback calculation on which the loan was based. Determination of whether forgiveness requirements have been attained can obviously only be determined at the end of the associated control or maintenance periods. Accordingly, a process is in place to monitor the loan recipient's performance relative to the original payback calculation.*

The Department previously performed payback calculations on loan and guarantees. As outlined [in] *the report, the risk of business failure was multiplied by the amount of assistance approved, to determine the potential amount of payout or loss for the Department. The estimated incremental payroll was multiplied by the assumed tax rate to arrive at an estimated annual return of tax revenue to the Province. The potential loss amount was then divided by the estimated annual return to arrive at the payback period, the amount of time it will take the Province to recover its estimated loss through increased tax revenue.*

This payback model for repayable loans and guarantees was abandoned six years ago as the model was considered severely flawed for the following reasons:

- *The risk of failure had no relation to the amount of actual loss on guarantees or loans. For instance, a company with a guarantee could have a 30% failure risk. Should that company fail however, the guarantee payout would be substantially higher than 30% of the guarantee, as we often experience payouts approaching the full guarantee amount subsequent to liquidation of security.*

- *Payback calculations by definition relate to return on the cost of the assistance. However, there is no initial assistance cost on guarantees or repayable loans. There could be a future cost should the*

> *company fail, but the amount is impossible to determine as guarantee amounts and direct loan balances reduce over time (due to loan repayment and guarantee reductions), and as the future value of security held in support of the repayable or guaranteed loan is impossible to predict .*

Accordingly, the Department does not intend to establish similar payback calculations for loans and guarantees. Quantitative benchmarks are established for this assistance in terms of forecasted job creation and maintenance, and actual job results are tracked by the department.

Re: Conclusion:

The audit report concludes that "we still feel that the level of monitoring done by the Department is not sufficient, and clearly documented policies and procedures either do not exist or are not consistently applied. The Department also needs to improve the reporting of information about the effectiveness of the FAIP in its annual reports".

The Department disagrees with the conclusion that monitoring is insufficient, but feels it must be better documented to demonstrate what has been done. As well, the Department concurs with the need for better defined policies and procedures, within reason. Accordingly, the Department will be implementing the following measures:

- *will produce quarterly non-compliance monitoring reports (by officer) to enable improved monitoring by management of related project executive follow-up activities, and will also explore amendments to the* Economic Development Act *to enable increased interest rates and fees on non-compliant accounts (reference audit criterion 2);*

- *will require that staff document in the file the methods used and actions undertaken to investigate information where concerns exist as to its accuracy (reference audit criterion 3);*

- *will develop policies and procedures relating to the review and verification by staff of information provided by clients in conjunction with loan forgiveness, and will ensure that memos are on file summarizing the forgiveness rationale and steps taken by officers in reviewing and verifying information on all future loan forgiveness transactions (reference audit criterion 4);*

- *will develop a policy requiring i) that a memo summarizing the information analyses undertaken in conjunction with account monitoring activities be placed on the file for all future reviews, ii) that the minimum requirements for such a review be specified in terms of issues and critical information to be reviewed, and iii) that any recommended mitigation steps be summarized in the memo as appropriate (reference audit criterion 5);*

The department will continue to report on the achievement of goals in its annual report, but intends to only provide information on specific goal targets if so requested at main estimates or at the Public Accounts Committee.

We wish to thank your office for its comments and for the opportunity to review and comment on this report. It is hoped that implementation of the above-noted actions will improve the monitoring of this assistance portfolio and its effectiveness.

Appendix A: Summary of 1998 audit findings on Financial Assistance to Business Program

Audit area	Summarized findings
Approvals	· The Department did not adequately document its own decision-making in its files · The Department did not sufficiently analyze and review assertions made by the applicants · Staff were not following departmental policy and procedures
Monitoring	· Departmental monitoring was not sufficient to safeguard provincial investments · Staff were not following departmental policy for monitoring · Monitoring activity was not well documented in the client files
Reporting	· The Department was not complying with the annual report policy of the Province

Appendix B: Case studies

AV Nackawic Inc.

2.107 AV Nackawic Inc. entered into an asset purchase agreement with the Province to purchase the assets of St. Anne-Nackawic Pulp Company Ltd in July 2005. The Department provided AV Nackawic with a $20 million direct loan and a $20 million loan guarantee for the purchase of the facility. Another direct loan of $26.75 million was offered in 2006 for retrofits and capital expansion. The mill switched to producing dissolving pulp in 2008. The Department loaned $10 million in the same year to assist the conversion.

2.108 It is the Department's standard procedure to send the applicants a letter indicating whether the request has been approved. Normally, the Department would list the terms of the financial assistance, conditions and restrictions, other requirements, and an account monitoring plan. In this particular case, the account monitoring plan required the company to provide:

- audited annual financial statements of the company within 120 days of the close of its financial year;
- the auditor's management letter and the company's response to the management letter;
- quarterly financial statements with comparison to budget 30 days after each quarter end;
- an annual statement from the company's solicitor as to the status of any outstanding legal claims against the company;
- a listing of the management of the company and their respective salaries; and
- an annual confirmation of insurance.

2.109 The letter also required the company to:

- consider the use of New Brunswick goods and services where possible in terms of cost, quality and availability; and
- make all reasonable efforts to ensure that employees of the company are provided the opportunity to upgrade skills through training or education.

2.110 As these were an integral part of the conditions of financial assistance, one would expect the Department to monitor the company's purchasing and training activities besides all the financial related information outlined in the account monitoring plan of the Department.

2.111 The Department has been able to obtain the company's audited annual financial statements, quarterly financial statements, and financial forecast. The Department also monitored the dividends payout, shareholder loans, salaries of management, capital spending or asset sales, inter-company transactions, change of ownership, and non arm's-length consulting which were the restrictions set up by the Department. In general the Department monitored the required documents listed in the account monitoring plan. However, there was no monitoring activity related to the company's purchase of goods and services and training plans of the company.

Atlantic Yarns

2.112 The Province started providing financial assistance to Atlantic Yarns in 1997. Total financial assistance approved was $42.25 million in the forms of equity, loan guarantees, direct loans, and forgivable loans. The Province also provided financial assistance totalling $41.5 million to Atlantic Fine Yarns. Both companies are owned by the same owner.

2.113 The Department's account monitoring plan for this client listed very similar document requirements as AV Nackawic, i.e. quarterly and annual financial statements, auditor's management letter and response, financial forecasts, and insurance confirmation. The Department also restricted the paying of dividends, issuing shareholder loans, spending on capital in excess of $1 million, paying high salaries and bonuses to management, conducting related party transactions unless at fair market value, and changing ownership.

2.114 Based on the document requirements and restrictions set up, one would expect the Department to ensure all the requirements and restrictions are satisfied. According to the Department's compliance review in 2007, there is "no current financial info – unable to verify compliance with restrictions". The latest audited financial statements were the ones for the fiscal year ended 31 December 2004. However, the Department paid out new financial assistance to the company in the following year.

2.115 As of 31 March 2008, total outstanding financial assistance was $36.8 million for Atlantic Yarns and $38.9 million for Atlantic

Fine Yarns. The Department obtained approval to write off the outstanding amounts. There has been no write-off of any outstanding amounts of financial assistance provided to either company at this time. However the Department set up the full amounts as loan loss provision.