



**Report of the Auditor General  
of Canada to the Legislative  
Assembly of Nunavut—2007**

**Audit of the Nunavut Business  
Credit Corporation Activities**



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





Auditor General of Canada  
Vérificatrice générale du Canada

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To the Honourable Speaker of the Nunavut Legislative Assembly:

I have the honour to transmit herewith my report on the Audit of the Nunavut Business Credit Corporation activities to the Nunavut Legislative Assembly in accordance with the provisions of section 48 of the *Nunavut Act*.

Yours sincerely,

Sheila Fraser, FCA  
Auditor General of Canada

Ottawa, 5 November 2007



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# Audit of the Nunavut Business Credit Corporation Activities

## Nunavut Business Credit Corporation

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### Main Points

#### What we examined

The Nunavut Business Credit Corporation (NBCC) serves the needs of small businesses in Nunavut that have problems getting financing from banks and other lending institutions. It is a Crown corporation, reporting to the Legislative Assembly through the Minister of Economic Development and Transportation. The Government of Nunavut provides it with funds for its day-to-day operations. To provide loans and other financial help to businesses, the Corporation borrows from the government with the approval of the Financial Management Board.

In auditing the NBCC's books of account for the year ending 31 March 2006, we found a number of irregularities in the Corporation's activities and in how they were accounted for. We advised the Corporation's Board of Directors and the deputy ministers of both the Finance and the Economic Development and Transportation departments that we could not form an opinion on the Corporation's financial statements.

To better understand the underlying causes at the root of these problems, we decided to examine what management and financial controls the Corporation had in place to operate and manage its business. Our examination included its loan approval process, its documentation of transactions and decisions, and its monitoring of loans in its portfolio. We also looked at the Board's responsibilities to oversee the operations of NBCC.

#### Why it's important

Any corporation is required to make its financial position clear to its shareholders; maintaining proper books of account and following proper accounting practices are not optional. When the corporation is a Crown corporation, the shareholder is the government and this adds other kinds of requirements. As a Crown corporation, the NBCC must follow the *Nunavut Business Credit Corporation Act* and Regulations and relevant sections of the *Financial Administration Act*. It is also expected to reflect the government's priorities in planning its activities, and it is expected to report its plans and the related results clearly to the Minister.

**What we found**

- We decided to carry out this audit after we had to issue a denial of opinion on the Corporation's financial statements for the year ended 31 March 2006. A denial of opinion is an expression by the auditor that no audit opinion can be provided because of significant limitations on the audit. In this case, because of NBCC's inability to keep proper books of account, we were unable to obtain enough appropriate audit evidence to form an audit opinion. This is a serious problem for the Corporation. Furthermore, during the audit, the Chief Executive Officer of the Corporation and most of the employees left and the few who remained had little knowledge of the Corporation and where to find the records we needed. In addition, we learned that much of the information we were looking for had been deleted or had not been kept on file. Given these circumstances, we do not have our usual degree of assurance with regard to the completeness of the record of events, nor were we able to conclude whether or not fraudulent acts had taken place.
- We found a serious breakdown of basic financial controls, such as approving transactions, authorizing payments, and confirming that what is being paid for has been delivered. In a number of cases, staff released funds to potential borrowers before loans were approved; staff also issued payments without having proper supporting documents and without confirming that the funds would be used for the approved purpose—in some cases, it appears that they were not. We also noted numerous transactions by the Corporation that contravened laws and regulations to which it is subject.
- Files were managed poorly. Documentation was missing from all of the files we reviewed; in one case the entire file was missing. Some documentation was stored in various filing cabinets, some on the shared computer drive or employees' laptops at NBCC, some at the lawyer's office in Ottawa. Data had been erased from the network. Data backup systems failed to operate.
- The Board of Directors did not carry out their responsibilities to oversee the operations of NBCC and ensure the protection of public funds entrusted to it—for example, in approving loans without adequate information. Further, they received little training and orientation. The Board Chair was heavily involved in the management of the Corporation's day-to-day operations, which contributed to confusion over proper roles and responsibilities.



- Given the significance of the problems identified in our audit and the limited number of NBCC employees, the Government may wish to reconsider the separate corporate structure it currently has in place to achieve the public policy objectives of helping to create employment and contributing to economic development.

***The Government has responded.** The Government is in agreement with the report and its recommendations. In its response to each recommendation throughout the report, the Government has indicated the actions it has taken, will take, or will consider taking.*

In the context of this report, the “Government Response” required the direct involvement of the Corporation, and the departments of Economic Development and Transportation, and Finance among others. Therefore it does not mean a response on behalf of duly elected officials of the Government of Nunavut.



## Introduction

1. The Nunavut Business Credit Corporation (NBCC) is a Crown corporation of the Government of Nunavut. It provides small businesses in Nunavut with loans and other financial help that they have a hard time getting from banks and other lending institutions.
2. The NBCC reports to the Legislative Assembly through the Minister of Economic Development and Transportation. It is governed by a Board of Directors appointed by the Commissioner in Executive Council on the recommendation of the Minister. The NBCC is governed under the *Nunavut Business Credit Corporation Act* and Regulations, as well as Part IX of Nunavut's *Financial Administration Act*.
3. During our review period, the Corporation had a Chief Executive Officer and, at various times, up to five other employees. It was left without a comptroller for more than a year, from March 2005 to April 2006. The NBCC Act requires the Corporation to have a Board of no fewer than seven directors and no more than twelve. Since February 2007, the Board has had only six directors. One Director submitted his resignation to the Chair in February and had not been replaced at the time of this report.
4. The Corporation receives about \$450,000 from the Government of Nunavut each year to cover the cost of its day-to-day operations. The funds that it lends to its customers are advanced to it from the government's consolidated revenue fund, with the approval of the Financial Management Board; \$50 million is the total amount that it can borrow, a limit established in the NBCC Act. At the time of our audit, the Financial Management Board had approved up to \$25 million.
5. **Problems identified in previous audits.** In our reports on other matters, presented to the Legislative Assembly of Nunavut in 2001, 2002, 2004, and 2005, we identified significant weaknesses in Nunavut's Crown corporations generally and in NBCC specifically. They included weaknesses in financial management and controls, staffing, and corporate governance. Moreover, our audit opinions on the NBCC's financial statements from 2001 to 2005 referred to the Corporation's non-compliance with authorities related to loan approvals, its failure to adhere to borrowing limits, and its late submission of its annual report to the Minister responsible for its operations.
6. In our audit of the Corporation's books of account for the year ending 31 March 2006, we found several irregularities in the

Corporation's activities and in how they were accounted for. We told the Board of Directors that given the state of the books of account and the state of the files on the Corporation's transactions, we would not be able to provide an opinion on the financial statements.

7. We therefore issued a denial of opinion for the 2005–06 fiscal year. A denial of opinion is an expression by the auditor that no audit opinion can be provided because of significant limitations on the audit. In this case, because of NBCC's inability to keep proper books of account in 2005–06, we were unable to obtain enough appropriate audit evidence to form an audit opinion. A denial of opinion is very rare. It indicates a very serious problem. In NBCC's case, it indicated that the lack of available audit evidence was so material that we could not determine whether the Corporation's overall financial statements presented information fairly.

8. We also reported this situation to the deputy ministers of Finance and of Economic Development and Transportation, and we shared our concern about how the Corporation was conducting business.

9. To better understand the underlying causes at the root of these problems, we decided to examine what management and financial controls the Corporation had in place to manage and operate its business.

#### **Focus of the audit**

10. Our audit examined the Corporation's controls over financial management and its financing practices and activities as well as the quality of its records and information systems. We also looked at how the Board oversees the direction of the Corporation to ensure that laws, regulations, government priorities, good business practices, and accountability to the Legislative Assembly are respected.

11. We interviewed staff and senior representatives of the departments of Finance and of Economic Development and Transportation. We also interviewed the Chair of the Board of Directors. At a meeting of the Corporation's Board of Directors on 5 December 2006, we provided a detailed plan setting out the work we would carry out in this audit. Further details are found at the end of the report in **About the Audit**.

12. Given the state of the Corporation's records and the departure of its Chief Executive Officer and most of its employees at the time of our audit, we do not have our usual degree of assurance with regard to the completeness of the record of events set out in this report.

## Observations and Recommendations

### Managing financing activities

13. At 31 March 2006, the NBCC had approved more than 62 loans to more than 51 businesses in Nunavut, for a total of about \$22.7 million. The total amount actually paid out to the borrowers was about \$17.9 million; the amount owed by each borrower averaged \$290,000. Of the total number of loans, 23 percent are to construction businesses, 19 percent to real estate businesses, and 18 percent to retail businesses.

14. The NBCC Act limits the Corporation's activities to providing loans, loan guarantees to financial institutions, and bonds. The Corporation is also required to obtain collateral from borrowers as security for loans. It is not to incur any expense on behalf of a borrower before a loan is approved or step into the management of any borrower's activities to maintain a loan. In addition, the Corporation is not allowed to give grants and contributions to any organization.

15. **Good management and financial controls are basic to any business.** Any lending institution needs to have controls in place to evaluate and approve new loan applications or renewals properly, to pay out the loans, and to manage and monitor its loans. It needs to have similar controls when it offers guarantees or bonds, all in order to minimize any potential financial losses. Basic controls include approving transactions, authorizing payments, and confirming that the disbursed loan funds were actually used for the originally approved purpose for the loan.

16. Good financial management is a critical part of running the day-to-day operations of any department or corporation. It is central to delivering programs and enabling organizations to manage public money carefully and honestly. With good financial management, an organization can manage its assets and liabilities and track its revenue and spending, produce complete and accurate financial statements, and account for how it uses its funding.

17. Well-functioning management and financial controls are also important to ensure that assets are safeguarded and that business operations are economic and efficient. Moreover, they are important mechanisms to ensure that an organization complies with, for example, key sections of the *Financial Administration Act* and the *Nunavut Business Credit Corporation Act* and related regulations and bylaws. They also help guide staff in the proper way to evaluate loan

applications, pay out funds, manage and monitor ongoing loans, and manage files.

**There was a breakdown of the Corporation's basic financial controls**

18. If an organization does not have proper financial controls, there is a risk that transactions not authorized in laws and regulations will occur. Indeed, we found a serious breakdown of the financial management and control framework at the Nunavut Business Credit Corporation. One consequence, as shown throughout this report, was that the Corporation entered into transactions that contravened the *Financial Administration Act* and the *Nunavut Business Credit Corporation Act*.

19. Our audit found that the Corporation lacked the most basic level of control. In short, it did not have the financial controls that would have enabled it to meet even the basic requirements for financial management set out in the *Financial Administration Act*. The following are examples:

- there was no comprehensive set of policies and procedures used to guide lending activities and disbursements;
- files were poorly managed and incomplete;
- staff had not carried out adequate review and challenge in approving loans (there was little evidence that applicants were assessed for credit worthiness or the viability of their business);
- management and monitoring controls over the completeness and accuracy of its information, including electronic data, were poor;
- the default rate for loans approved since 1 April 2004 was higher than for previously approved loans; and
- there were transactions that did not comply with legislation.

20. **NBCC does not have a comprehensive set of policies, procedures, and guidelines to guide its operations.** Written guidelines are a key tool for delivering any financing program consistently, fairly, and transparently. They can provide clear criteria for eligibility, conditions for receiving financial support, and guidance on levels of support to provide. Written guidelines can be particularly useful when staff turnover is high, as it has been in the Corporation.

21. We expected that the Corporation would have in writing, for example, the steps to take when a request for funding is received,

and how to assess the request. We also expected that it would have policies on

- the privacy and security of confidential information,
- electronic data and information technology,
- proper file documentation,
- loan renewals,
- monitoring of loans (including assessing collateral used as security for loans and reviewing financial information),
- foreclosure of loans and possession of collateral used for security, and
- level of risk the Corporation could tolerate in its loan portfolio.

**22.** We found that, although the Corporation had inherited procedures from the Government of the Northwest Territories that existed upon Division and that were still valid, in the period covered by our audit the Corporation operated without regard to written procedures and guidelines. As a result, there was no consistency in how it selected and approved projects and how it decided what types of loans it would approve. Employees told us that there were no written guidelines and procedures. We were told that guidelines and procedures were developed when a situation called for them. For example, the former Chief Executive Officer (CEO) informed us that the Corporation had no guidelines on loan foreclosures, because they were not NBCC's practice.

**23. Documentation was incomplete or missing.** We found that documentation was missing from virtually all the loan files we reviewed; in one case, the entire file was missing. Some documentation was loosely stored in various filing cabinets or on the shared computer drive at NBCC. Some information was at the lawyer's office in Ottawa. Other information was not easily accessible—for example, about 60,000 emails, some of which contained information on loan activity, were stored on the hard drive of the CEO's computer. These emails were not properly sorted and indexed for easy access. In addition, some conversations with clients in which terms and conditions of loan agreements had been changed were not documented in the files, and electronic data that may have contained information related to loans had been erased. We were given no satisfactory explanation for these occurrences, which are not a part of normal business practice.

**24.** Furthermore, documents such as signed loan agreements and information on securities held as collateral could not be found. This lack of documentation made it extremely difficult—in some cases,

impossible within any reasonable period of time—to reconstruct key events and discussions about borrowers' accounts.

**25. Data backup and recovery systems failed to operate as designed.** During our audit procedures we wanted to perform detailed testing of past transactions and correspondence. We tried to obtain copies of email and financial documents from the Corporation's data backup systems, which are maintained through NBCC's information technology service provider. After making several attempts and receiving incomplete data, we determined that the Corporation's backup and recovery systems failed to operate, despite terms in its contract with its service provider that called for backups to be made regularly.

**26. Recommendation.** The Government of Nunavut should ensure that the procedures and guidelines inherited by the Nunavut Business Credit Corporation upon its creation are reviewed to assess their continued relevance and applicability; should update them where needed, in order to guide staff in fulfilling their responsibilities; and should ensure that they are followed. These updated procedures and guidelines should be based on best practices in the lending industry, adjusted for the particular circumstances of the Corporation and of conducting business in Nunavut. The Corporation should also review the procedures periodically to take into account changing internal and external circumstances. Among others, the procedures and guidelines should address

- the documentation and the review and challenge steps needed for assessment of a loan/guarantee/bond file and the approval process to be followed;
- privacy requirements and the protection of confidential information, both written and electronic;
- the process for renewing a loan or changing the terms and conditions of a loan;
- the loan-monitoring process, including periodic review of a client's financial data;
- follow-up on loans in arrears;
- the process for deciding when and how a loan should be foreclosed.

**Government's response.** *The Government agrees with this recommendation and the suggestions for improvement provided with it. The Corporation has commenced this review, through the retention of business*



process consultants, legal and in-house staff reviewers. These reviews will produce a completely updated Operational Procedures Manual. A protocol to address updates and to provide for periodic and ongoing monitoring, evaluation and updating of the Corporation's guidelines and procedures is being developed. This will also form part of the Corporation's Operational Procedures Manual.

The procedures and guidelines inherited by the Corporation from the Government of the Northwest Territories have now been reinstated. Their continued relevance will be assessed as the first step of the review.

Several recommendations in this review reference the need for adequate, current and correct documentation, policies, procedures and practices. Without limiting responses to individual recommendations, the Corporation, with the strong assistance of the Government is formulating an action plan that will ensure the proper implementation of all the standards outlined in the report. This will result in the Corporation possessing an Operational Procedures Manual that is up-to-date, user-friendly and topical. This manual will be used to guide virtually all aspects of the Corporation's business practices, and will be continually monitored and evaluated to ensure that it is always current.

**27. Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation develops formal standards for documentation to guide staff. This should include defining the minimum documentation to be kept on file to fully support the analysis and rationale for decisions made.

**Government's response.** The Government agrees with this recommendation and will work closely with the Corporation to ensure that best practices for standards in file documentation are followed and that decisions made on applications are fully supported and documented in the file. In the interim, a checklist of required documentation for a typical file has been developed by the Corporation and has been in use for some period of time, ensuring that each and every file is complete, correct and up to date.

**28. Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation establishes proper data backup and recovery procedures to allow for effective functioning and timely recovery of business transactions in the event of a disruption to normal activities. Backup copies should be stored off-site to minimize the risk of data being lost. Backups should be tested periodically.

**Government's response.** The Government agrees with this recommendation. Currently the Corporation is ensuring that its computer services supplier, which is located off-site, is adhering to an industry standard

*data backup and security regime. At the same time, the Corporation is investigating several other avenues of computer system and file protection, including the use of existing Government of Nunavut technologies, which will allow it to preserve its data properly and provide for timely data recovery, if necessary.*

**Loan applications were not evaluated adequately before being recommended for approval**

**29.** A major element of success for the Corporation is sound decision-making when approving applications for loans. Applications for up to \$500,000 are approved by the Board of Directors; those over \$500,000 are approved by the Minister. The Board and the Minister rely on staff of the Corporation to provide information on the applicant's credit worthiness and the viability of the applicant's business or project. To provide reliable information, staff would have to adequately review and challenge the applicant's credit worthiness and the validity of the borrower's assessment of the viability of the project.

**30.** Based on our review of files, staff of NBCC did not carry out adequate review and challenge in assessing the data submitted by the applicant on the viability of the business and its ongoing prospects for success and growth. There was little evidence that NBCC had properly evaluated the credit worthiness of the applicant, the value of the business or asset to be purchased or built, the legitimacy of the equity that the owner proposed to contribute to the project, or the viability of the project. As a result, on any given loan approval, NBCC may have accepted a credit risk that was higher than indicated in the information presented to and approved by the Board of Directors.

**31.** To understand how decisions were made—given that they were rarely documented—we interviewed the former CEO, the comptroller (recently appointed at the time of our audit), and the Chair of the Board. The analyses of information for the Board on loan applications were done by the loan manager (who left the Corporation in August 2006); we found them to be poorly documented. In 16 of the 17 files we reviewed (94 percent), we saw no indication that the former CEO or any other employee had reviewed and challenged this work.

**32.** In the files we reviewed for recently approved loans, we found that 88 percent or 15 out of 17 files did not contain enough information for anyone to have assessed how much money was needed for the project or whether the applicant would be able to carry out the project and repay the loan. Analyses of profitability and cash flow were

either missing or insufficient. Assumptions used for forecasts were not defined, and the reasonableness of the forecasts was questionable.

**33.** For example, in 5 out of 17 loan files we reviewed (29 percent), NBCC staff had recorded a known problem of weak management skills or a history of poor cash management but had still recommended the loan for approval by the Board or the Minister. The loans were approved with no support to justify the recommendations for approval by the Board and no subsequent follow-up by management on the borrowers' financial status. All five of the borrowers had problems and, at the time of our review, were significantly behind in their loan payments. One owner had walked away from the business entirely, making only one payment after receiving the final disbursement of his loan, and NBCC has still not recovered its investment. Moreover, the analyses did not include a best-case and a worst-case scenario if the loan had to be recovered through liquidation or forced sale of the business.

**34.** In about 65 percent of the files we reviewed (11 out of 17), the information presented to the Board contained errors or was misleading due to omissions. For example, the Board was informed that a potential borrower had more than \$600,000 in cash reserves, while in fact that amount was invested in an affiliated company. The potential borrower actually had little cash flow.

**35.** NBCC staff did not independently verify or adequately challenge financial data and other information provided by clients. Independent verification is important to assess the accuracy, completeness, and validity of financial information provided in a loan application. In 15 of 17 files we examined (88 percent), we noted that financial information submitted by the applicant and used to assess the loan application was not reviewed, audited, or challenged by an independent source. It was not clear how or whether staff had checked the reasonableness of the information.

**36.** In addition, we saw little evidence that NBCC staff received or analyzed estimates of detailed project costs and recent appraisals of assets in order to substantiate the request for funding on the application. For example, on one file the client merely stated how much he was going to pay for the assets of a business he intended to purchase. There was no evidence on file that NBCC staff had confirmed what these assets were and whether they were worth what the client intended to pay.

**37.** Finally, to be sure that loan applicants will be able to meet their debt requirements, it is imperative that they be able and required

to invest equity in their business projects along with NBCC funds. Companies without enough equity could have trouble generating enough cash flow to meet large loan repayment obligations, especially in the start-up phase of projects. Adequate equity also demonstrates that the applicant is committed to the project's success and is willing to share some of the financial risk.

**38.** In about 24 percent of the loans we reviewed (or 4 files out of 17), the equity amount was either below the 10 percent required by the NBCC Act or was missing from the analysis. In the rest of the files, there was no evidence that staff had verified the borrower's proposed equity or the underlying value of services and assets that the borrower was contributing toward the project. Therefore, we could not determine whether and how NBCC staff had been assured that the proposed equity was in place and was reasonable.

**39. Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation reviews its loan approval procedures to ensure that

- analyses performed are complete and reliable;
- analyses are performed according to guidelines that detail what to look for and how to interpret the results;
- information prepared for the Board to support recommendations on loan applications is accurate and complete and verified by independent sources; if independent sources cannot be found, the rationale for the conclusion reached should be documented on file and brought to the attention of the Board of Directors at the time of the project's approval;
- the financial portion of the analysis is reviewed and challenged by the comptroller before applications are referred to the Board for approval;
- the Board is made aware of any special circumstances, judgment calls, and assumptions used in assessing the application; and
- information presented to the Board with applications for approval outlines the key risks for the Corporation, along with various options.

*Government's response.* The Government agrees with this recommendation and its suggestions for improvement. Further, the Corporation has already incorporated these suggestions into its current business practices and reinstated the existing procedural manual. Together with the Government, the Corporation will develop a formal procedural

*document with respect to the loan approval process and include it in its updated Operational Procedures Manual.*

### **Control over disbursements was poor**

**40.** We expected that the Corporation would make loan disbursements according to the terms and conditions of a signed loan agreement. We expected that disbursements would be supported by sales agreements, invoices for assets purchased, or contractors' progress reports on built assets. This would ensure that the assets existed, that projects were proceeding as planned, and that debtors were paid. We also looked for completion certificates in the files indicating that construction projects were complete and met all inspection requirements; this would protect NBCC's investment in the assets.

**41. Some disbursements were made without proper support.**

In 7 out of 17 files (41 percent) we noted that disbursements were made without the appropriate documentation to support them. For example, we noted that a payment of \$15,000 was issued twice to a borrower. Although the extra payment was eventually recovered, adequate controls over disbursements could have prevented this situation.

**42.** We found in 7 out of 17 files (41 percent) that NBCC staff released funds directly to the borrower without confirming that the funds would be used for the specified purpose of the loan, that all collateral was in place to secure the loan, or that the loan agreement had been signed by all parties. These poor disbursement practices increase the risk that if the borrower defaults on its loan, other creditors will be paid before NBCC. We noted other cases of unsecured lending that could lead to losses in the event of default.

**43.** Finally, we found that in two cases, NBCC paid legal and/or accounting fees totalling about \$6,000 on behalf of loan applicants; subsequently, the loans were not approved and NBCC could not recover the funds because it had no signed agreement with the borrower or any collateral as security. In more than 40 percent of the new approved loans we reviewed (7 out of 17 files), loan advances were made before a signed loan agreement or letter of offer was obtained.

**44. Funds that were disbursed may not have been used for their approved purpose.** In two of the files we examined, it was difficult for us to determine whether funds were disbursed for the approved purpose and for the benefit of the business. We found at least two cases

where the Corporation provided more money directly to the borrower than was needed for the purpose stated on the loan application.

**45. Recommendation.** Given that its mandate is restricted to providing loans, loan guarantees, and bonds, the Nunavut Business Credit Corporation should not incur costs on behalf of potential borrowers.

*Government's response.* The Corporation agrees with this recommendation. This practice has been discontinued. Potential borrowers are now directed to other programs that are available to assist them with their business needs prior to becoming clients of the Corporation.

**46. Recommendation.** Before paying out a loan or a portion of a loan, the Corporation should ensure that

- the loan has been approved by the appropriate authorities and the payment is properly supported with documentation, such as invoices from suppliers, statements of accounts confirming outstanding balances, confirmation from the lawyers that securities or collateral have been registered according to the loan approval form, and signed loan agreements; and
- individuals signing the cheques are provided with adequate supporting documentation before signing the cheque or authorizing electronic transfers of funds.

*Government's response.* The Corporation agrees with this set of recommendations and has already incorporated them into its loan review and approval process.

**The Corporation did not adequately manage and monitor its loans**

**47.** Management and monitoring of loans is important to ensure the collection of payments, compliance with the terms and conditions of loan agreements, and the long-term sustainability of the Corporation. Regular monitoring would identify loans coming up for renewal and follow-up. It would also identify any need for action on loans in arrears, such as restructuring, collection procedures, or foreclosure.

**48. The Corporation did not generate reports and reconcile loan repayments.** Our audit found that the Corporation did not periodically compare the monthly payments it actually received on loans against an expected loan repayment schedule. Therefore, any outstanding amounts went unnoticed. In fact, for at least six files, the Corporation did not receive loan repayments at various times during the year and this situation was not noticed for several months.

49. In addition, during the period covered by our audit, the Corporation adopted a software called The Exceptional Assistant (TEA) to support its loan operations program. We found numerous errors in the data that were input into the information system, TEA. As a result, interest and repayment of principal balances were calculated incorrectly on at least 14 loans out of 62, or about 23 percent of the total number of loans.
50. We also noted that terms and conditions of loans had been changed without prior approval by the Board of Directors, which the NBCC Act requires. We could not determine how many loans and what amounts were involved, given the incomplete state of the files. At the time of writing this report, the Corporation was still attempting to sort out the proper terms and conditions of its loans.
51. **NBCC did not take timely action on defaulted loans to protect its investment.** We found that collection efforts are lacking and that follow-up on payment arrears varies, from little effort in some cases to a lot of effort and involvement in others. On at least three loans that have been significantly in arrears for several years, NBCC has taken little action. Staff need to have guidance on how to decide what level of action is appropriate in which circumstances.
52. **Securities have expired and have not been renewed.** The Corporation's security interest in assets held as collateral for a loan are normally registered by a lawyer for a limited number of years. In June 2006, while performing our audit of the Corporation's accounts, we noted in at least 5 out of 62 files that liens on assets held as securities for loans had expired. This means that if the borrower stops repaying its loan, the Corporation no longer has a priority claim over those assets and might not be able to recover its funds. We brought this matter to the Board's attention during our financial audit, and the Corporation has since hired a lawyer to review the securities associated with its loan portfolio. At the end of our audit, a complete update and review of the loan securities had not yet been completed.
53. **Loans were not renewed when the terms were up.** Loans can be repaid over a long period. It is normal practice to set shorter repayment terms and to review them periodically. Of the 17 files we reviewed, we noted 6 loans whose terms had expired and had not been renewed, nor had the loans been repaid. In one case, the term had expired five years ago. In the event of a disagreement between NBCC and the borrower, the applicable terms and conditions might be difficult to determine and enforce.

54. Regular monitoring of loans is important to protect the Corporation's business and investment. The fact that loans expired without being renewed is an indication that financial and monitoring controls were not working.

55. **Internal reporting is lacking.** Internal reporting allows employees to follow-up on programs and activities. To be useful, it needs to be accurate, timely, and complete. Furthermore, when the information provided in reports indicates that problems exist, management needs to take timely corrective action.

56. As already noted, the Corporation has invested in The Exceptional Assistant (TEA), a new information system to help in the management of its loan portfolio. A variety of information is gathered in this system, such as the amount outstanding on each loan, the interest rate and term of the loan, period of the loan, and payments made against the outstanding balance of the loan. However, we found that the Corporation did not use the system or any other means to generate or produce regular internal reports to use in monitoring the status of its portfolio, although the system has the capability to generate this type of report.

57. We found that some reports were created and some information was presented to the Board, but only after several requests by Board members. The information in those reports was merely a list of transactions or loans, and we noted that the information was incomplete or inaccurate. Moreover, no context or explanation was provided for loans in arrears.

58. **Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation

- identifies the information it needs to monitor its activities and then develops reports that will provide it with this information; the reports should be distributed to relevant employees and analyzed, and corrective action should be taken when appropriate; and
- understands the reporting capabilities of its new information system, TEA; if necessary, the service provider should be asked to provide training.

*Government's response.* The Government agrees with these two recommendations. Corporation management is working to develop timely, accurate reports to ensure that ongoing monitoring and evaluation of client files is completed at regular intervals throughout the life of the loan. The Corporation is also developing a training plan to ensure that employees



*maximize the reporting capabilities of The Exceptional Assistant (TEA). Additionally, meaningful reports are now being prepared by staff and distributed to both Management and the Board for their perusal and action.*

**59. Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation

- reconciles loan repayments with the repayment schedule on a timely basis; any differences should be followed up;
- confirms the terms and conditions of existing loans and update its files; changes in terms and conditions should be properly approved as required by relevant authorities if they have been modified;
- conducts an independent review of the information captured in “The Exceptional Assistant” (TEA) information system to ensure its completeness and accuracy; access to this system should be restricted and monitored; any changes to underlying data should be reviewed and approved;
- takes appropriate and authorized legal action on defaulted loans when necessary;
- regularly monitors loans to ensure timely renewal of their terms;
- reviews and updates the underlying securities on the loans and verifies that they are still valid; if they are not, the Corporation should assess the status of the loan and whether additional securities are needed; and
- develops and reviews internal reports to regularly monitor its portfolio; among others, the Corporation needs information on arrears, upcoming renewals, loan securities, and the status of businesses on its “watchlist”—that is, businesses whose ability to repay their loans may be compromised.

**Government’s response.** *The Government agrees with this recommendation and its suggestions for improvement and will ensure that the Corporation integrates them into its ongoing business processes. Staff and consultants are evaluating the entire loan portfolio. That review, along with maximizing TEA capabilities and the production and use of reports generated from the system will greatly enhance the ongoing monitoring of the loan portfolio.*

**60. The Corporation failed to administer loans on behalf of the Kitikmeot Business Development Centre.** The Kitikmeot Business Development Centre is a federally incorporated organization that delivered a community futures program in the Kitikmeot region of

Nunavut. Its primary focus was to provide small businesses with loans of up to \$75,000. In 2001, the Minister responsible for NBCC directed the Corporation to take over the management of the Kitikmeot Business Development Centre. The Centre's Board of Directors was dissolved, its files were transferred to NBCC, and signing authority for its bank accounts was given to NBCC staff.

**61.** In a 2003 letter of instruction, the Minister directed the Corporation to find another organization as soon as possible to take over administering the development centre in order to free up time for NBCC's business. Responsibility for the Kitikmeot Business Development Centre was never transferred from NBCC. Instead, the loan files were stored in a cabinet and NBCC staff continued to receive bank statements for the Centre. However, bank accounts were not reconciled; NBCC staff were not monitoring the loans and made no effort to collect payments. At the time of this report, there were about 10 outstanding loans totalling about \$306,000, with more than \$400,000 in the Centre's bank account.

**62.** No financial statements have been prepared for the Kitikmeot Business Development Centre since 2001. We found that transactions made since 2001, when NBCC was directed to take over the Centre's management, were not recorded in the account books of either NBCC or the Kitikmeot Business Development Centre. Information was simply filed away in a cabinet and ignored.

**63.** We note that we raised the issue of NBCC's ongoing involvement in the management of the Centre's loan activities in our 2004 report to the Legislative Assembly.

**64. Recommendation.** The Nunavut Business Credit Corporation should ask whether it is still the wish of the Minister that it devolve responsibility for the Centre to another party as quickly as possible or to follow another path as directed by the Minister. In the meantime, it should manage the Centre's loans and prepare financial information as needed.

*Government's response.* The Corporation agrees with this recommendation. The Corporation is currently arranging to divest itself of this responsibility, while addressing its fiduciary duties in the short term.

### **There were numerous contraventions of laws and regulations**

**65.** As we have already noted in this report, part of good management and financial control is compliance with the applicable laws and regulations. We found a lack of due regard for the legislative

environment in which the Corporation operates. In addition to the non-compliance already noted, we found the following cases where NBCC failed to comply with laws and regulations:

- Interest rate policy was not in compliance with section 10(2) of the *Business Loans and Guarantees Regulations*, and borrowers were charged interest at rates both higher and lower than the prescribed rates. The prescribed rate is 2 percent above the prime rate offered by the financial institution that holds the consolidated revenue fund of the Government of Nunavut. The Corporation's rates varied from 0.5 percent to 5.5 percent above the prime rate. While the Financial Management Board (FMB) can approve interest rates below the prescribed rate, in 4 of 17 files we reviewed, the FMB's approval was not sought for rates charged that were lower than prescribed.
- The three-year limit on how long a borrower may make interest-only payments on a loan was exceeded for two loans—in one case by eight months and in the other case by more than two years. The three-year limit is set in the NBCC Act.
- Significant changes to loan terms and conditions were not properly authorized by the person(s) initially approving the loan, as required by section 41(1) of the NBCC Act. We noted changes in collateral held as security and changes in payment structures; in one case, we noted that the interest rate charged on a loan was changed from the rate initially laid out in the letter of offer. These changes were not approved before they took effect.
- NBCC exceeded the \$1 million limit permitted by the NBCC Act on loans to related parties. Two loans of \$1,000,000 each were approved for a parent company and its fully owned subsidiary. Although the Act permits the Board or the Minister to determine whether parties are related, a letter from NBCC management to the Minister indicated that the companies had developed independently from two unrelated companies, when in fact they had not.
- Section 89 of the *Financial Administration Act* (FAA) for Nunavut requires the Corporation to establish the form and content of its financial records in accordance with accepted accounting principles and practices. The FAA also requires it to establish and maintain systems and procedures to ensure that financial assets and other assets of the Corporation are properly managed, accounted for, and controlled, and that all payments are properly authorized. As noted in our financial audit opinion for the year

ended 31 March 2006, the Corporation did not maintain proper books of account or a system of internal controls over revenues and expenses.

**66. Recommendation.** The Nunavut Business Credit Corporation should ensure that key legislative authorities that apply to the Corporation are identified, understood and complied with. It should provide training to employees and Board members on the provisions of the applicable authorities, regulations, and by-laws.

*Government's response.* The Corporation agrees with this recommendation and the suggestions for improvement. Current Corporation staff is well versed in the appropriate legislative authorities and have been following them closely. Regular employee and Board training sessions will be created and delivered as necessary, along with proper checks, balances and controls, which will form part of the Operational Procedures and Board Orientation Manuals.

## Governing the Corporation

**67.** The NBCC Act makes the Board of Directors responsible for directing the business of the Corporation. Its duty is not to manage the Corporation but to oversee the management of the Corporation in the best interests of both the Corporation and the government. This includes safeguarding the Corporation's resources, monitoring its performance, and reporting to the Minister.

### The Board needs to play a stronger oversight role

**68.** Our audit found that the Board of Directors did not exercise sufficient oversight and control to direct the operations of NBCC in order to ensure that the public interest and the funds entrusted to it were protected. The consequences were made worse by the fact that the former CEO did not discharge his duty to be sure that appropriate management practices were in place so that the Corporation would conduct its business with due care.

### Roles and responsibilities of the Board are not clearly defined and carried out

**69.** It is the Board's responsibility to ensure that in carrying out NBCC's activities, employees comply with the laws and regulations that apply to the Corporation. We found that members of neither the Board nor management were fully aware of the requirements of the *Financial Administration Act*, the NBCC Act and related regulations, and the bylaws of the Corporation.

**70.** We found that the roles and responsibilities of the Board are not clearly defined and carried out. There are no terms of reference listing

what the Board is expected to do. Normally, a board's responsibilities include making sure that

- it has approved the direction in which management plans to take the Corporation in the next few years,
- plans and activities are moving in the approved direction and are consistent with government priorities,
- key risks are known and plans are made to reduce their effects if they happen,
- the Corporation's activities respect laws and regulations,
- public funds entrusted to the Corporation are protected, and
- employees of the Corporation understand and respect the rules against conflict of interest.

Had Board members been aware of these responsibilities and carried out them, many of the problems described in the previous section of this report might have been avoided.

**71. Recommendation.** The Government of Nunavut should ensure that the Nunavut Business Credit Corporation develops terms of reference for the Board of Directors and makes sure that new Board members receive a copy along with training when they are appointed. It should also ensure that each Board Director understands

- the roles and responsibilities of the various parties involved in the governance of the Corporation (such as the Financial Management Board, Cabinet, the Minister, and the Department of Economic Development and Transportation);
- the importance of a strong, professional working relationship among the various parties involved;
- the role and responsibilities of the Board and its various committees, if any.

**Government's response.** *The government agrees with this recommendation. Terms of Reference will be jointly developed with the Corporation, implemented and clearly explained to the Board.*

**72. Board members receive insufficient training and orientation.** We looked at whether collectively, Board members would have the independence, the knowledge and skills, and the access to resources needed to carry out their responsibilities effectively. We found that the Board did not have nor did it acquire the knowledge and skills that would normally be expected in a Board of this nature. The Board

lacked sufficient experience in finance and would have benefited from having members with experience increased in economic development and legal matters.

**73.** In the past, the NBCC has not provided new directors with the orientation and information they need to ensure that they can carry out their duties effectively. We noted that an orientation session was provided at the first Board meeting after the new directors were appointed in April 2006, but it lacked information on statutory responsibilities, financial literacy, and the public sector environment.

**74.** We also noted that the Board did not identify areas where training was needed or where gaps in knowledge and skills might have been filled by external consultants. Board members did not take advantage of the training programs that were available. For example, training in conjunction with another financial organization in the Territory had limited attendance by the NBCC Board members.

**75. Recommendation.** The Board should participate in training geared to increasing its knowledge of best practices in corporate governance and financial management. This training should include an orientation session that clearly outlines the responsibilities of the Board and of individual directors and that provides new directors with the information they need to carry out their responsibilities effectively. Training should also cover the Board's role in and responsibility for the Corporation's long-term planning and also its role in ensuring that the annual corporate plan contributes to achieving the long-term strategic plan.

*Government's response.* The Corporation agrees with this recommendation. A board orientation and training process will be put in place to ensure that the Board is fully able to carry out its responsibilities. The Board has also received the re-instituted staff Operational Procedures Manual.

**76. Responsibilities of the Chair of the Board and the CEO are not clearly separated.** In most Crown corporations, the board is accountable to the Minister through the chairperson. In NBCC's case, however, a May 2003 letter of instruction from the Minister delegated the authority of the Minister to the Deputy Minister for the Department of Economic Development and Transportation. This reporting relationship continued when there was a change of ministers.

**77.** A Chief Executive Officer generally reports to the board. In NBCC's case, however, the CEO's contract mentions a reporting relationship only with the Deputy Minister for the Department of

Economic Development and Transportation; it makes no reference to the Board. Further, we also noted that there is no formal agreement between the Board and the CEO to clearly outline what the Board expects of this position and how the CEO's performance is to be measured. In the 2003 letter of instruction, the reporting relationship of the CEO to the Deputy Minister is referred to as a "dotted line." This usually implies a close working relationship, which could cause confusion for the CEO if he were to receive mixed messages from the Deputy Minister and the Board.

**78.** We found that the nature of this reporting relationship varied during the period covered by our audit, with the Deputy Minister becoming more involved at the Minister's direction. In December 2006, the Minister directed the Board to instruct the CEO to report directly to the Deputy Minister of Economic Development and Transportation.

**79.** When the Chair and the CEO of a corporation are separate positions, as they are at NBCC, the Chair normally manages the affairs of the Board while the CEO manages the day-to-day operations of the corporation. In NBCC's case, however, we found that the Chair was very involved in the Corporation's day-to-day operations, corresponding almost daily to provide detailed instructions for work to be done. We were informed by the Chair of the Board that this involvement was necessitated due to management's inability to complete the priorities assigned by the Board. However, this involvement of this type can hinder a board's ability to hold management accountable for achieving objectives and can undermine the participation of other board members in decision making.

**80. Recommendation.** The Government of Nunavut, in cooperation with the Minister if necessary, should clarify the roles and responsibilities of the Board, including its Chair, the CEO, and the Deputy Minister.

*Government's response.* The Government agrees with this suggestion. The Minister will consider a realignment of roles and responsibilities, as appropriate.

**81. Recommendation.** Clear expectations for the CEO and performance measures to evaluate progress toward them should be developed by the individual(s) to whom the CEO reports.

*Government's response.* The Corporation and the Government agree with this recommendation and will work together to produce a mandate letter for

*the CEO that will clearly outline yearly expectations and performance, complete with performance measures and targets.*

**82. Minutes of Board meetings do not provide sufficient information on the nature of discussion and decisions.** We noted that the minutes of Board meetings did not always provide enough detail on the nature of the discussions, options considered, or analyses provided to support important decisions. For example, discussions about loan applications are held in camera. Minutes are not kept of these discussions. The resulting records of decisions were very brief, indicating only the loan number and that the loan was approved and providing no information on the amount of the loan or the approved terms and conditions.

**83. Recommendation.** Minutes of Board meetings should reflect the nature of discussions held, options considered, and decisions reached.

*Government's response.* The Corporation agrees with this recommendation. The Corporation will develop and adopt a Board minute policy that provides the reader with adequate disclosure and information while protecting the confidentiality of Board discussions and decisions.

## Conclusion

**84.** Because we could not obtain enough appropriate audit evidence to form an opinion on the Corporation's financial statements for the 2005–06 fiscal year, we had to issue a denial of opinion. We decided to look at the Corporation's management and financial controls in order to better understand what led to this serious situation.

**85.** We found that the Nunavut Business Credit Corporation did not use appropriate management and financial controls in processing loan applications. We found a serious breakdown of basic financial controls. The Corporation did not follow existing guidelines and procedures or carry out adequate review and challenge of information on loan applications. We noted numerous transactions by the Corporation that contravened laws and regulations to which it is subject. Furthermore, management and monitoring controls on the existing portfolio were limited. Files were managed poorly and documentation was missing in all the files we reviewed.

**86.** The Board of Directors did not clearly understand its roles and responsibilities. The Board did not exercise sufficient oversight and control to direct the operations of NBCC and protect the public funds



entrusted to it. Moreover, Board Directors were not provided with sufficient training and orientation.

**87.** The Nunavut Business Credit Corporation needs procedures and guidelines to identify credit risk problems and actions to be taken, to estimate potential losses in the portfolio; and to monitor and report on the overall credit risk of the portfolio on an ongoing basis in order to minimize potential losses.

### **Looking ahead**

**88.** As described throughout this report, NBCC has not kept adequate records and books of account in order to generate complete and accurate financial records. This is a critical priority. Once the Corporation begins to produce complete and accurate financial information, it should take steps to identify non-financial performance targets for its activities. It should then begin to regularly measure, monitor, and report on its progress toward those targets. Both financial and non-financial information is needed to help an organization assess and report its progress toward its stated objectives—in NBCC’s case, contributing to employment creation and economic development in Nunavut.

**89.** The financial and management deficiencies we have noted throughout this report are serious and numerous, and correcting them will be a significant challenge. At the same time, we recognize that NBCC is a small organization with only a limited number of employees. Given the circumstances, the Government may wish to reassess the desirability of continuing to operate these programs through a separate corporate structure. Having the programs operate as part of a larger organization might enable it to draw upon other resources and expertise needed to implement our recommendations in a timely manner.

**90.** In the context of this report, the “Government Response” required the direct involvement of the Corporation, and the departments of Economic Development and Transportation, and Finance among others. Therefore it does not mean a response on behalf of duly elected officials of the Government of Nunavut.

## About the Audit

### Objective

The objective of our audit was to determine whether effective management and financial controls were in place to manage and monitor activities of the Nunavut Business Credit Corporation and whether the related roles and responsibilities were clearly defined and understood.

### Scope and approach

We reviewed the financing activities carried out by the Nunavut Business Credit Corporation. For the transactions we looked at, we reviewed compliance with legislative requirements.

**Sampling of financing activities.** We identified the loans and other financing granted to borrowers between 1 April 2004 and 30 September 2006. We judgmentally selected 17 higher-value files for review. Other files were reviewed for specific matters such as controls over the disbursement of loans.

**Sampling of disbursements.** We identified the payments issued between 1 April 2005 and 30 September 2006 against financing activities and judgmentally selected payments for review.

**Interviews and document reviews.** We conducted interviews with staff and the Board of NBCC and with officials of the Department of Economic Development and Transportation and the Department of Finance. We also reviewed the files and documentation related to the management, delivery, and results of the Nunavut Business Credit Corporation. A general review of emails and electronic documents was conducted as necessary to complete the review of our sample of files.

The audit did not examine the effectiveness of NBCC's lending program.

### Criteria

We conducted the audit using the following criteria:

- The roles and responsibilities of the Board for oversight of the Corporation are clearly defined and understood.
- The Corporation has appropriate management and financial controls on the processing of applications for financing, including policies and procedures to evaluate and rate credit risk on individual applications and ensure that files are processed with adequate diligence and in accordance with applicable legislation.
- Appropriate management and financial controls are in place to manage and monitor the existing portfolio, including policies and procedures to identify credit risk problems; to estimate credit impairment in the portfolio; and to monitor and report on the overall credit risk of the portfolio on an ongoing basis in order to minimize potential losses.

### Audit Work Completed

Audit work for this report was substantially completed in February 2007.

**Audit team**

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