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Audit Report

Canada Small Business Financing Program

Audit and Evaluation Branch

June 2013

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Departmental Audit Committee on July 10, 2013.

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1.0 Executive Summary

1.1 Introduction

Established in 1961, the Canada Small Business Financing Program (the Program or CSBFP) helps small businesses obtain access to financing that would not otherwise be available or would only be available under less favourable terms. It does this by encouraging financial institutions across the country to make their financing available to small businesses that are eligible under the Program. By partnering with private sector lenders (financial institutions), Industry Canada shares the risk of loan losses and thus is able to increase the amount of financing extended to small businesses.

The statutory Program operates under the *Canada Small Business Financing Act* (the Act) and the *Canada Small Business Financing Regulations* (the Regulations).

Under the Program, financial institutions can make term loans on real property, leasehold improvements and equipment. Financial institutions are responsible for:

- Determining that businesses requesting financing meet CSBFP eligibility requirements
- Approving loans
- Disbursing the loan proceeds
- Registering the loans with the CSBF Program
- Administering the loans, and
- In the event of default, realizing on the security and guarantees.

If a registered loan defaults, CSBFP pays lenders 85% of the net eligible losses subject to review and approval of claims submitted by lenders.

The Program receives revenues from lenders in the form of registration and administration fees:

- A registration fee of 2% of the amount financed, paid at the time of loan registration; and
- An annual administration fee of 1.25%, paid quarterly on outstanding loan amounts.

Over the three fiscal years from 2009-10 to 2011-12, the Program registered on average approximately 7,400 loans per year. During that period, the Program paid on average approximately 1,600 claims annually totalling an average annual spend of approximately \$84M.

In the same period, the Program had average annual revenues of approximately \$52M. During fiscal year 2011-12, registration fee revenues totalled approximately \$19.8M and administration fee revenues were approximately \$33.5M.

The Act requires a Comprehensive Review of the CSBFP every five years. The Review for the 2004-09 lending period, tabled in Parliament in April 2010, found that the Program continues to be a successful, efficient mechanism for facilitating asset-based debt financing to small businesses. However, the administrative burden and low profitability for lenders associated with the Program's design contributed to declining usage by lenders during the period of the review.

Program officials are working towards addressing recommendations (which include both regulatory and non regulatory changes) identified during the review process to modernize the Program and reduce the paperwork burden. Officials have also implemented measures to increase Program awareness among small businesses.

In accordance with the approved Industry Canada 2012-2015 Multi-Year Risk-Based Internal Audit Plan, the Audit and Evaluation Branch undertook an audit of the Canada Small Business Financing Program.

The objective of the audit was to provide assurance that the Program's governance, risk management and internal control processes support the delivery of the Program's mandate and priorities in the areas of:

- 1 - Operational planning, risk management, management of human resources (HR planning and training), and change management.
- 2a - Program controls over loan registration, administration fee and claims processing are adequately designed to address Program risks and ensure compliance with key elements of the Canada Small Business Financing Act and Regulations.
- 2b - Program controls over claims processing are operating effectively and claims are paid out in accordance with key elements of the Act and Regulations.

While some exceptions were noted, overall the audit revealed that the Program's governance, risk management and internal control processes support the delivery of the Program's mandate and priorities in the areas identified above.

1.2 Main Findings and Recommendations

Operational Planning

The Program has clearly articulated priorities, and operational plans are in place to implement the established priorities.

Risk Management

The Program periodically assesses its business and operating environments to identify issues and risks. The Program considers risk information as part of the planning and priority setting exercise.

The Program does not follow a comprehensive risk management approach, including a consolidated and documented list of all key Program risks that is reviewed and updated periodically and linked to a formal risk assessment with mitigation strategies that contain timelines for implementation and related risk owners.

Recommendation 1: The Director General (DG), Small Business Branch (SBB) should implement a risk management approach to assist the Program in formally identifying, assessing, mitigating and monitoring key Program risks and to ensure mitigation strategies for risk areas are carried forward in priority setting and reflected in operational plans as appropriate.

Management of Human Resources (HR Planning and Training)

A process is in place to assess and identify current and future human resources requirements. Where the Program has identified HR related risks, it has put in place a plan to address its needs.

Training procedures, tools and templates exist to support consistent delivery of the Program.

Change Management

The Program has engaged and informed external stakeholders and internal Program staff about the proposed changes to the CSBFP Regulations.

A work plan has been developed to identify activities, individuals and timelines for the implementation of Program changes as a result of proposed changes to the Regulations.

Loan Registration / Administration Fee process (Control Design)

Overall, controls over the loan registration and administration fee processes are in place and effectively designed to mitigate Program risks and ensure compliance with key elements of the Act and Regulations.

The audit identified a specific gap in the control design related to the completeness and accuracy of administration fees the Program receives from lenders. Based on the Program's preliminary analysis, this gap applies to a small percentage of the overall loan portfolio.

Recommendation 2: The DG, SBB should assess the potential impact of the identified control gap and determine what mitigation strategies, if any, are required and feasible to implement to address this gap.

Claims Process (Control Design and Effectiveness)

Overall, controls over the claims process are in place and effectively designed to mitigate Program risks and ensure compliance with key elements of the Act and Regulations.

Based on the audit's sample testing, Program controls over the claims process are operating effectively and claims are paid out in accordance with key elements of the Act and Regulations.

1.3 Audit Opinion

In my opinion, overall, the Program's governance, risk management and internal control processes support the delivery of the Program's mandate and priorities with some exceptions noted. Improvements are required to address low to medium risk exposures in the areas of risk management and administration fee control design.

1.4 Conformance with Professional Standards

This audit was conducted in accordance with the Internal Auditing Standards for the Government of Canada, as supported by the results of the Audit and Evaluation Branch's quality assurance and improvement program.

Susan Hart
Chief Audit Executive, Industry Canada

2.0 About the Audit

2.1 Background

In accordance with the approved Industry Canada 2012-2015 Multi-Year Risk-Based Audit Plan, the Audit and Evaluation Branch (AEB) undertook an audit of the Canada Small Business Financing Program.

The purpose of the Program is to help small businesses obtain access to financing that would not otherwise be available or would only be available under less favourable terms. The Program partners with private sector lenders (financial institutions) across the country who make their financing available to small businesses that are eligible under the Program. By doing so, Industry Canada (IC) shares the risk of loan losses and thus is able to increase access to financing extended to small businesses.

The statutory Program operates under the *Canada Small Business Financing Act* and *Canada Small Business Financing Regulations*, and was designed to increase the availability of financing for the establishment, expansion, modernization and improvement of small businesses.

The Program is delivered within the Small Business, Tourism and Marketplace Services Sector, and its activities are directly linked to IC's Strategic Outcome that Canadian businesses and communities are competitive. Specifically, the Small Business Financing Directorate (within the Small Business Branch) is responsible for designing and administering the Program under the provisions of the Act and its Regulations.

The Directorate is divided into four units that work together to deliver the Program:

- Operations
- Program Integrity (external stakeholder relationships and communications)
- Policy
- Economic and Policy Analysis.

The Operations unit is involved in the day to day administration of the Program. The unit's staff registers loans, collects fees, reviews claims and authorizes payments to lenders for eligible portions of losses on defaulted loans.

Under the Program, financial institutions can make term loans on real property, leasehold improvements and equipment. Financial institutions are responsible for:

- Determining that businesses requesting financing meet CSBFP eligibility requirements
- Approving loans
- Disbursing the loan proceeds
- Registering the loans with the CSBF Program
- Administering the loans, and
- In the event of default, realizing on the security and guarantees.

The Act and Regulations require lenders to act with due diligence in the approval and administration of loans as they would with their own conventional loans.

If a registered loan defaults, CSBFP pays lenders 85% of the net eligible losses, subject to review and approval of claims submitted by lenders. The Act establishes a liability ceiling for each five-year lending period. This represents the maximum amount of the Minister's aggregate contingent liability with respect to the aggregate principal of loans made by all lenders. The Act also limits each lender's liability for losses on CSBFP loans.

The Program receives revenues in the form of registration and administration fees. When a loan is registered, the Program receives a registration fee of 2% of the amount financed; an annual administration fee of 1.25% is paid quarterly on outstanding loan amounts. Thus, in addition to the Program's primary objective of facilitating financing for small businesses, the Program also aims to achieve a reasonable level of cost recovery (i.e., to offset claims on defaulted loans with Program revenues).

The Small Business Financing Directorate has 31 full-time equivalent positions, of which nearly half are involved in operations (i.e., loan registration, administration fee and claims processing). The annual operating cost of the Small Business Financing Directorate to administer the CSBFP is approximately \$5M.

Over the three fiscal years from 2009-10 to 2011-12, the Program registered on average approximately 7,400 loans per year. During that period, the Program paid on average approximately 1,600 claims annually, totalling an average annual spend of approximately \$84M. The number of loans registered and claims paid annually have decreased over the last three years.

In the same period, the Program had average annual revenues of approximately \$52M. During fiscal year 2011-12, registration fee revenues totalled approximately \$19.8M and administration fee revenues were approximately \$33.5M.

Current developments

The Act requires a Comprehensive Review of the CSBFP every five years. The Review for the 2004–09 lending period, tabled in Parliament in April 2010, found that the Program continues to be a successful, efficient mechanism for facilitating asset-based debt financing to small businesses. However, the administrative burden and low profitability for lenders associated with the Program's design led to declining usage by lenders during the period of the review.

Program officials are working towards addressing Review recommendations (which include both regulatory and non regulatory changes) to modernize the Program and reduce the paperwork burden.

Among these measures are regulatory amendments designed to address stakeholder concerns and improve access to financing for small and medium enterprises (SMEs). The proposed amendments were pre-published in October 2012 to allow stakeholders a formal opportunity to comment on them. The amendments are awaiting approval.

Non-regulatory measures include a registration system that enables electronic registration and fee payments with financial institutions. The Program has been rolling out the system over the past year. The system is expected to speed up the registration process and reduce the paperwork associated with registration and fee payments. Program officials are also working with business support organizations to increase awareness of the Program among small businesses.

2.2 Objective and Scope

The objective of the audit was to provide assurance that the Program's governance, risk management and internal control processes support the delivery of the Program's mandate and priorities in the areas of:

- 1 - Operational planning, risk management, management of human resources (HR planning and training) and change management
- 2a - Program controls over loan registration, administration fee and claims processing are adequately designed to address Program risks and ensure compliance with key elements of the Canada Small Business Financing Act and Regulations.
- 2b - Program controls over claims processing are operating effectively and claims are paid out in accordance with key elements of the Act and Regulations.

The scope of the audit included an assessment of Program activities, processes and controls in the areas identified in the audit objective. The audit covered Program activities and processes up to December 31, 2012. Samples for testing controls over the claims process were selected from claims processed during the period from April 1 to December 31, 2012.

Scope Limitation

The audit team tested the operational effectiveness of controls in the area of claims processing. One of the controls was the sign-off by reviewers of the Program audit checklist, as evidence that the claim file review process had been completed.

Towards the end of the conduct phase of the audit, the audit team was made aware of a change to the expected operation of the control thereby limiting the ability to test and conclude on the effectiveness of this control. Specifically, the requirement for dual reviewer signatures came into effect in November 2012. The sample selected for testing (April – December 2012 claims) did not align to the correct implementation date. As a result, the sample did not provide enough coverage for the audit team to conclude on the operation of the control from November onwards.

In addition, the audit team was informed that reviewer signatures may have been added to some of the files in the sample after the files had been selected for testing but before the auditors had reviewed them.

2.3 Audit Approach

This audit was conducted in accordance with the *Internal Auditing Standards for the Government of Canada* and the Treasury Board *Policy on Internal Audit*. The audit procedures followed and the data collected are sufficient and appropriate to attest to the accuracy of the conclusion and the opinion expressed in this report. This opinion is based on a review of the situations identified in time and place, based on pre-established audit criteria agreed upon with management. This opinion applies solely to the entity reviewed and the framework described in this report.

During the planning phase of this audit, a risk assessment of the Program was completed to confirm the audit objective and identify areas requiring a more in-depth review during the conduct phase.

In addition to the risk assessment, the audit team considered the Treasury Board Secretariat's Management Accountability Framework tool for assessing Core Management Controls (CMCs) as defined in March 2011. A detailed assessment of the CMC criteria was performed to look for areas that might not have been considered in the stand-alone risk identification process.

Based on the identified risks and the CMC assessment, AEB developed audit criteria that linked back to the overall audit objective. Appendix A lists these audit criteria.

The methodology for this audit included but was not limited to document review, interviews, walkthroughs, claim file reviews and controls testing. The sample sizes selected for claim file reviews and controls testing were based on the overall population size during the sampling period and the level of evidence required to conclude on the overall audit criteria.

For the claim file procedures, the audit team also considered key Act and Regulation requirements which were incorporated into the overall review of each claim file. To perform this testing, the audit team selected key aspects of the Act and Regulations that presented a higher financial and/or reputational risk to the Program. For each requirement, the audit team reviewed the claim files to verify the existence of documentation supporting the claim reviewer's assessment.

A debrief meeting was held with management on May 14, 2013 to validate the accuracy of the findings contained in this report.

3.0 Findings and Recommendations

3.1 Introduction

This section presents detailed findings from the audit of the Canada Small Business Financing Program. The findings are based on evidence and analysis from the initial risk assessment and the detailed audit work.

In addition to the findings below, AEB has communicated verbally and/or in a management letter, findings that were either non-systemic or of low risk to management for consideration.

3.2 Operational Planning

The Program has clearly articulated priorities, and operational plans are in place to implement the established priorities.

Priority setting and operational planning is an important function in every organization to better focus resources in key priority areas and ensure activities are identified and aligned with those priorities.

During the 2012-13 Departmental Integrated Planning exercise, the Program identified program modernization as a key priority. The 2010 Comprehensive Review and consultations with stakeholders indicated that the Small Business Financing Directorate would need to focus on examining ways to improve and modernize the Program to make it more appealing for lenders to offer loans to SMEs.

This finding led to the identification of three key business objectives (sub-priorities) for the Small Business Financing Directorate to address the overall priority of modernizing the Program:

1. Implement changes that will improve and modernize the CSBF Program.
2. Increase the awareness and uptake of the Program, particularly amongst the SME borrowing community.
3. Continue to roll out Phase III of the CSBFP IT system, which permits lenders to transfer registration documents and fees electronically.

For each of these three priorities, the audit team assessed whether the Directorate had operational plans that linked back to the established priorities and facilitated the co-ordination of Program resources so that the overall Program priorities and objectives could be achieved.

In reviewing the operational plans of each of the Program's four units, the audit team found that the priorities and business objectives identified during the Departmental Integrated Planning exercise are linked to the Program's operational plans and priorities documents at the unit level. Each of the units in the Directorate identified key priorities and developed operational plans for the fiscal year. The audit team found that each unit has in place operational plans that identified activities to be executed to implement the Program's key priorities and responsibilities.

Discussions with Program management indicated that a process is in place for assigning the activities in the operational plan to individuals, with associated timelines. Unit managers are responsible for following up with these individuals to monitor the progress of implementation.

3.3 Risk Management

The Program periodically assesses its business and operating environments to identify issues and risks. The Program considers risk information as part of the planning and priority setting exercise.

The Treasury Board Secretariat's Framework for the Management of Risk defines risk management as a systematic approach to setting the best course of action under uncertainty by identifying, assessing, understanding, making decisions on and communicating risk issues. Effective risk management adds value as a key component of decision-making, business planning, resource allocation and operational management.

During the conduct phase of this audit, Program management indicated that Program unit managers meet with the Director on a weekly basis to share information and address issues that may impact one particular unit or the Program as a whole. Each unit has also either bi-weekly or monthly team meetings to discuss or identify emerging/new issues and discuss the status of various projects or activities.

Interviews revealed that issues or risks identified by the managers are either addressed within the unit or reported to the Director, depending on the severity of the issue. Minor issues are typically addressed by the manager, medium-level issues are brought to the Director's attention in their weekly meetings and major issues are escalated to the Director immediately. When issues are identified on a day-to-day basis, managers develop courses of action with deadlines and present and discuss them with the Director.

Interviews with Program management also indicated that each unit periodically assesses the environment for issues and risks that might arise within the four Program units. Activities to support the assessment include, but are not limited to:

- Tracking of data related to Program delivery/performance, such as:
 - Types of questions received via telephone or email
 - Number of website hits
 - All forms of correspondence with lenders and other stakeholder groups

- Running regular reports to monitor trends and Program statistics, such as:
 - Volume of claims received and processed
 - Number of rejected claims – i.e., areas of lender non-compliance
 - The Minister's liability
 - Loan registration trends
 - Missing information from lenders
 - Statistics on alleged improprieties

- Identifying Program issues through the five-year Comprehensive Review and/or other reviews related to Program activities (e.g., Comptrollership and Administration Sector testing of Revenue controls)
- Obtaining information from the Program's database on alleged improprieties
- Continuously updating the forecasting models for the Program's revenues and expenses.

Program management also indicated they consider risk information obtained as a result of performing the above activities when they set priorities and develop operational plans at the beginning of the fiscal year.

In addition, for the Operations unit, the audit team reviewed the 2011-14 three-year on-site verification plan and noted that risk information was used as an information source in developing the plan. The plan is a risk mitigation tool the Program uses to assess whether lenders are complying with Act and Regulations requirements. For example, it considers whether a lender has exercised due diligence in the approval and administration of a loan and whether the documentation submitted to the Minister about the borrower is accurate and complete.

The Program adopts a risk-based approach in developing the on-site verification plan. It considers various risk factors such as lender non-compliance with the Regulations. The three-year plan is reviewed annually to assess whether new information or issues identified during the previous year should affect the plan's content.

The Program does not follow a comprehensive risk management approach, including a consolidated and documented list of all key Program risks that is reviewed and updated periodically and linked to a formal risk assessment with mitigation strategies that contain timelines for implementation and related risk owners.

In interviewing Program management and reviewing risk related documentation, the audit team found that a consolidated list of documented Program risks does not exist; however, the Program did provide key Program risks during the audit.

These risks are:

- Systems access and project management:
 - Risks relating to systems applications and access
- Operational requirements:
 - Business continuity planning (for IT systems applications/components)
 - Employee turnover in specialized areas
- Fraud:
 - Risks related to fraud activity related to the Program and the mechanisms in place to deter and detect fraud.

The risks identified were not formally assessed for impact or likelihood; however, in discussing these risks with Program management and reviewing documentation, the audit team noted that Program activities appear to be addressing the identified risks.

Without a consolidated and documented list of all key Program risks, Program risks/issues identified informally throughout the year may be overlooked and subsequently not be considered as part of the planning and priority setting process.

Furthermore, the Program may not implement mitigation strategies in a timely manner or may set aside mitigation activities while responding to more urgent needs. The consideration of likelihood and impact during the risk assessment process would help the Program determine which activities should be prioritized over others when time or resource constraints arise.

Recommendation 1: The Director General, Small Business Branch should implement a risk management approach to assist the Program in formally identifying, assessing, mitigating and monitoring key Program risks and to ensure mitigation strategies for risk areas are carried forward in priority setting and reflected in operational plans as appropriate.

3.4 Management of Human Resources (HR Planning and Training)

A process is in place to assess and identify current and future human resources requirements. Where the Program has identified HR related risks, it has put in place a plan to address its needs.

The effective management of human resources is essential to ensuring the continued delivery of the Program in a consistent and timely manner.

The Program uses the semi-annual performance review process to identify current and future human resources requirements. Interviews with Program management indicated that, as part of IC's performance review process, managers are encouraged to engage staff twice a year to determine their short and long term career plans. Through this process, the managers identify employees who may be considering other work or retirement as well as employees who require additional training.

For employees considering other work or retirement, the Directorate puts in place a succession plan and/or staffing plan to appropriately mitigate this risk. When an impending staffing need is identified, the Program documents its staffing needs in the Directorate's HR plan, which is used as input for the Sector's plan of staffing actions.

In instances where a position required very specific skills and knowledge of the Program (e.g., the Revenue Control Officer position), a succession plan was put in place to identify a successor and provide training and transfer of corporate knowledge.

If an employee lacks necessary skills and requires training, this will be documented in the employee's personal learning and career plan and the manager will allocate a portion of the budget for that training where possible.

Training procedures, tools and templates exist to support consistent delivery of the Program.

Interviews with Program management and review of training manuals and procedures documents demonstrated that the Small Business Financing Directorate has training tools and procedures in place to ensure consistent delivery of the Program. Program staff responsible for operational delivery of the Program are required to review the Act, Regulations and Guidelines to ensure they understand how to apply them.

The audit team noted that some units had developed a more structured approach to training because of the specificity and complexity of their responsibilities.

Tools and templates

Each of the Program's four units has tools and templates that are aligned with regulatory requirements and that are used as part of the training process for new employees.

The operational staff responsible for delivering the core business of the Program (i.e., registering loans, collecting revenues from registration and administration fees, and reviewing and approving claims) has tools and templates that are aligned with the requirements of the Act and Regulations. These include loan registration forms, claim for loss forms and internal audit checklists for reviewing and approving claims.

Training and supervision

The training approach used in the Program Integrity and Operations units ensures new employees are adequately supervised and trained before they are allowed to perform tasks on their own.

In the Program Integrity unit, new employees are closely supervised before they are allowed to take calls or send emails directly to external stakeholders. The trainer/supervisor also listens to recordings of employee calls and identifies areas requiring improvement (e.g., incorrect answers to questions). In such situations, employees will be pulled off calls for further training until they are able to answer questions correctly.

Similarly, in the Operations unit the training officer will review sample claim files with a trainee before the trainee is allowed to process actual claims alone with the training officer available for questions as needed. The trainee will have all information requests reviewed by the training officer before it is sent to lenders until the officer is convinced that such review is no longer necessary.

Documented training procedures

The Program Integrity and Operations units have documented several of their key processes, and officers are required to review these documents before carrying out their tasks.

In the Program Integrity unit, all new employees are required to read the unit's manual as well as the Act, Regulations and Guidelines. For training purposes, the unit also provides recordings of info-line discussions. The following key communications processes are documented:

- “List Manager” information import
- Ministerial correspondence
- Responses to requests for information emails
- Access to Information and Privacy.

The Operations unit has developed a checklist for training follow-up requirements for a new program officer. Trainees review Guidelines, Bulletins, policy interpretations, the Act and Regulations and procedures with a training officer, as well as the tools and systems used by the Program.

3.5 Change Management

The Program has engaged and informed external stakeholders and internal Program staff about the proposed changes to the CSBFP Regulations.

Organizational change management is defined as a concerted, planned effort to increase organizational effectiveness. Elements include the presence of a change plan and the extent to which stakeholders are engaged when change is undertaken. Planning and communication are key elements in ensuring that change initiatives are properly implemented.

In 2010, the Small Business Financing Directorate engaged external stakeholders to inform them about the five-year review of the Program. The Directorate gave the stakeholders (e.g., lenders and national business support organizations) a document that outlined the areas of the Program that could change. This document served as the basis for discussion at subsequent meetings with external stakeholders.

In October 2012, amendments to the Regulations were pre-published in the Canada Gazette Part I for a comment period of 30 days. At this time, the Directorate told external stakeholders about this opportunity to comment and provided an informal clause-by-clause analysis of the rationale and intent behind each proposed change. The Directorate also informed borrowers and lenders of the next steps in the amendment process.

The Small Business Financing Directorate has also developed a communications strategy and plan in collaboration with the departmental Communications and Marketing Branch to implement the regulatory changes. The communications strategy outlines the following:

- Communications objective
- Summary of a public environment analysis
- Summary of media coverage to-date
- The target audience and reactions of stakeholder groups
- Key messages
- Communications approaches and tactics.

Interviews with Program management and a review of meeting agendas indicated that internal Program staff were also regularly informed, through monthly or bi-weekly team meetings, about the regulatory changes and the impact those changes could have on staff responsibilities. Each unit in the Directorate holds bi-weekly or monthly team meetings during which the status of the proposed regulatory changes is discussed, as appropriate.

Program staff have also been engaged in preparing internal and external communications products and tools that reflect the anticipated regulatory changes, including:

- Updates to brochures and marketing materials
- Adding or changing IT system requirements for the internal system used to register and track CSBFP loans and claims
- Updates to external communications products such as the CSBFP Guidelines, Bulletins, loan registration forms, and claim for loss forms
- Updates to internal communications tools such as policy interpretations and checklists for reviewing claim files.

A work plan has been developed to identify activities, individuals and timelines for the implementation of Program changes as a result of proposed changes to the Regulations.

The audit team reviewed the Directorate's work-back schedule and interviewed Program management to confirm that a process was in place to identify and monitor activities for the implementation of the Program's proposed changes.

The work-back schedule lists tasks required for successful implementation of the regulatory changes. For each task, the schedule provides timelines, task owners and overall status. Tasks documented within the schedule covers the following main activities:

- Obtaining final approval of the amendments
- Updates to guidelines, forms and templates
- Modifications and testing of the CSBFP application
- Preparation of Bulletins
- Updating and preparing communication material.

In addition to the work back schedule, the Program established a Regulatory Committee (an internal group) including Program managers and the Director (Small Business Financing Directorate) to discuss the progress of the activities in the schedule and to resolve issues. The work-back schedule is updated prior to each Regulatory Committee meeting.

3.6 Loan Registration / Administration Fee process (Control Design)

Overall, controls over the loan registration and administration fee processes are in place and effectively designed to mitigate Program risks and ensure compliance with key elements of the Act and Regulations.

The Program requires that participating lenders pay a loan registration fee of 2% of the amount of the loan as well as an annual administration fee of 1.25% paid quarterly on the outstanding loan balance. The Act and Regulations specify the conditions under which loans should be registered and fees collected.

The audit assessed whether Program controls over the loan registration and administration fee processes are adequately designed to ensure compliance with key elements of the Act and Regulations and address Program risks.

A brief summary of each process is provided below.

Loan Registration Process

The loan registration process includes the following activities:

- Lenders submit a completed loan registration form to the Program along with a cheque to cover the 2% registration fee.
- The cheque and the loan registration form are submitted to the Program for processing in the CSBFP system.
- The Program subsequently reviews all amounts entered into the system against cheques received.
- A reconciliation is performed monthly to ensure amounts entered into the CSBFP system reconcile to amounts entered into the Integrated Financial Management System (IFMS). The reconciliation is reviewed by the manager of Operations.

Administration Fee Process

The administration fee process includes the following activities:

- On a quarterly basis, lenders submit an administration fee report with a cheque for the 1.25% administration fee to the Program for processing in the CSBFP system. The report provides a breakdown of the fees owing for each quarter and the average month end principal balances for all loans registered with the Program.
- For the last quarter (i.e., Q4), lenders must also submit either an external audit report attesting to the calculation of the administration fees for the year, or a detailed loan report that includes a breakdown of all loans with month end balances as well as a calculation of the administration fee. If a detailed loan report is provided, a recalculation is performed on a sample of loans to verify the accuracy of the calculation and the accompanying fees.
- The Program performs a subsequent review of all amounts entered into the system against cheques received (mail register).

- A monthly reconciliation is performed to ensure that amounts entered into the CSBFP system reconcile to amounts entered into IFMS. The reconciliation is reviewed by the manager of Operations.

The audit team performed a walkthrough of each of the above processes with relevant process owners to identify and assess the controls in place to address Program risks, including the risk of non-compliance with Act and Regulation requirements. Specific risks identified during the walkthrough included but were not limited to:

- Cheques received are not accurately recorded in the CSBFP system
- Loans are registered with incomplete or missing information
- Lenders are not paying the correct amount of fees
- Fees recorded in the CSBFP system are not consistent with fees recorded in IFMS
- Administration fees are not paid on time
- Lenders do not provide adequate documentation to substantiate the payment of administration fees.

For risks identified, the audit team assessed controls within each of the processes to see if they mitigate risks to an acceptable level. The team found that various controls are in place and include appropriate segregation of duties, reviews of data entry, automated system controls and monthly reconciliations. Based on the assessment performed, the audit team concluded that the controls in place are adequately designed to mitigate Program and non-compliance risks.

The audit identified a specific gap in the control design related to the completeness and accuracy of administration fees the Program receives from lenders. Based on the Program's preliminary analysis, this gap applies to a small percentage of the overall loan portfolio.

Based on the walkthrough performed, the audit team noted that the Program does not have a control that assesses the completeness and accuracy of lender reported administration fees, specifically for those lenders who do not have an independent audit performed.

The current process requires that the Revenue Control Officer performs a recalculation of the detailed loan report provided to verify the accuracy of the calculation and the accompanying fees. However, no verification is performed to ensure that the report provided is in fact complete and includes all loans for the purposes of reporting on administration fees. Furthermore, no mechanism is in place to ensure that loan balances reported in the administration fee report are accurate.

In light of the control gap noted above, there is a risk that the Program may not be collecting the proper amount of administration fees owed by the lenders. Specifically, there is a risk that:

- Lenders who do not have independent audits performed may not properly report the number of loans in their administration fee calculations
- Loan balances reported in administration fee reports are inaccurate, resulting in an incorrect amount of administration fees being received.

These risks are mitigated in part by the Program's on-site verification process, which occasionally assesses whether administration fee revenues received from lenders are accurate and complete. The above risks are also isolated to lenders who do not provide an independent external audit report. Based on the Program's preliminary analysis, these lenders represent a small percentage of the overall loan portfolio.

Recommendation 2: The DG, SBB should assess the potential impact of the identified control gap and determine what mitigation strategies, if any, are required and feasible to implement to address this gap.

3.7 Claims Process (Control Design and Effectiveness)

Overall, controls over the claims process are in place and effectively designed to mitigate Program risks and ensure compliance with key elements of the Act and Regulations.

The Act and Regulations establish a number of conditions and requirements that must be met for claims to be paid out. The Program is not directly involved in the loan approval process; it must therefore exercise proper due diligence in the review and approval of claims.

For this reason it is imperative that the Program have controls in place that are designed adequately and operating effectively to ensure that claims are properly reviewed and paid out in accordance with the Act and Regulations.

Claims Process

The claims process includes the following activities:

- When a borrower defaults on a CSBFP registered loan, lenders may submit a claim for loss form to the Program providing details of the loss along with supporting documentation.
- The Program performs a detailed first review of the documentation submitted by the financial institution to ensure it meets all the requirements of the Act and Regulations.
- After the first review, a second detailed review of the claim file is performed in which all supporting documents are reviewed again.
- Once both reviews have been completed and the Program is satisfied that the claim meets the requirements of the Program and that the claim payment would not result in exceeding the lender's cap, payment of the claim is confirmed by exercising the delegated financial authority (Section 34 of the *Financial Administration Act*).
- A monthly reconciliation is performed to ensure claim amounts entered into the CSBFP system reconcile to amounts entered into IFMS. The reconciliation is reviewed by the manager of Operations.

The audit team performed a walkthrough of the claims process with relevant process owners to identify and assess the controls in place to address Program risks including the risk of non-compliance with the Act and Regulations. In addition to the risk of not meeting the requirements in the Act and Regulations, other Program risks include:

- Claims are paid on loans that have already been fully repaid by the borrower
- Claims information entered into the CSBFP system is incorrect
- Section 34 of the *Financial Administration Act* has not been appropriately exercised
- The claims amount approved for payment in the CSBFP system is inconsistent with the claims amount paid and recorded in IFMS.

Based on the walkthrough performed, the audit team identified controls that support the Program's processing of claims and help mitigate the identified risks. These controls included:

- Using an audit checklist to aid in the claims file review; the checklist highlights key requirements that link back to the Act and Regulations and that each officer must assess during the file review
- Using a claim for loss notes form to highlight issues or areas for follow-up during the file review
- Section 34 sign-offs to evidence approval of claim payment
- Monthly reconciliations of the CSBFP system and IFMS.

Based on the assessment AEB performed, the controls in place are adequately designed to mitigate Program and non-compliance risks.

Based on the audit's sample testing, Program controls over the claims process are operating effectively and claims are paid out in accordance with key elements of the Act and Regulations.

After performing walkthroughs of the claims process, the audit team identified and tested key controls. Testing involved selecting samples and verifying whether the controls were operating effectively throughout the sample period. Controls testing included:

- For a sample of 60 claim files, verifying that appropriate FAA section 34 sign-offs exist on claim for loss forms for each claim approved for payment
- For each of the 60 claim files tested, reviewing key Act and Regulations requirements posing higher financial or reputational risk to the Program. The audit team reviewed claim files to verify the existence of documentation supporting the reviewer's assessment that the particular Act or Regulations requirement had been met. Examples of Act and Regulations requirements that were considered during testing included:
 - the outstanding loan amount in relation to the borrower did not exceed limits set out in the Act

- the amount of the loan did not exceed 90% of the cost of eligible asset purchases
- the liability of the Minister in respect of losses sustained by a lender did not exceed 85% of the eligible loss

- For a sample of 4 extension of claim submission date requests, verifying that the requests are appropriately approved and evidenced via a sign-off by the Portfolio Manager

- For a sample of 2 monthly claims reconciliations, verifying that monthly claims reconciliations between the CSBFP system and IFMS are prepared, reviewed and evidenced via sign-offs by the Commerce Officer and the Manager of Operations respectively.

For each control selected for testing, the audit team performed the testing procedures identified above and found no exceptions in the samples tested. As a result of the file review and controls testing performed, the audit team found the controls to be operating effectively; claims tested were paid out in accordance with key elements of the Act and Regulations.

3.8 Management Response and Action Plan

The findings and recommendations of this audit were presented to Program management. Management agreed with the findings included in this report and will take actions to address the recommendations by September 30, 2013.

The Program will develop and implement a risk management plan. The Program will also complete its analysis and continue to explore the feasibility of additional measures to further mitigate the risk identified in relation to the completeness and accuracy of the administration fees received.

4.0 Overall Conclusion

While some exceptions were noted, overall the audit revealed that the Program's governance, risk management and internal control processes support the delivery of the Program's mandate and priorities in the areas of:

- Operational planning, risk management, management of human resources (HR planning and training), and change management; and
- Loan registration, administration fee and claim processing.

Improvements are required to address low to medium risk exposures in the areas of risk management and administration fee control design.

Appendix A: Audit Criteria

Governance		Criteria Met / Met with Exception(s) / Not Met
1. The Program has in place operational plans and activities that consider resource requirements and link back to established Program priorities.		Met
Risk Management		Criteria Met / Met with Exception(s) / Not Met
2. The Program has an approach to risk management which includes periodically identifying, assessing and mitigating risks affecting the Program.		Met with exceptions
3. Risk information is used to support planning and setting of Program priorities.		Met
Internal Control		Criteria Met / Met with Exception(s) / Not Met
4. HR Planning considers current and future resource requirements, which includes identification of knowledge and capacity needs as well as providing employees with training and tools to support consistent delivery of the Program.		Met
5. The Program has work plans in place to ensure change initiatives are properly implemented and communicated.		Met
6. Program controls over the loan registration process are adequately designed to address Program risks and ensure compliance with key elements of the Act and Regulations.		Met
7. Program controls over the administration fee process are adequately designed to address Program risks and ensure compliance with key elements of the Act and Regulations.		Met with Exceptions
8. Program controls over the claims process are adequately designed to address Program risks and ensure compliance with key elements of the Act and Regulations		Met
9. Program controls over the claims process are operating effectively and claims are paid out in accordance with key elements of the Act and Regulations.		Met