
Performance Audits



3 Economic and Rural Development and Tourism: Financial Assistance to Businesses through NSBI and IEF

Summary

In late 2009 we began, but later withdrew from, an audit of the financial assistance programs at the Industrial Expansion Fund (IEF) and Nova Scotia Business Inc. (NSBI). In our June 2010 Report we denied an opinion on key controls due to refusals by both organizations to provide information required for the audit. Following the enactment of a new Auditor General Act in December 2010 which clarified our right of access, we returned to IEF and NSBI, received the information we required, and completed the audit.

IEF has few processes, controls or documentation to support the review and evaluation of applications for loans or other assistance. The only substantial documentation consists of confidential reports to Cabinet. This enhances the risk of inconsistent or inequitable treatment of applicants, inaccurate or incomplete analysis and recommendations, and poorly informed decisions. A recently established Advisory Committee has no oversight role. Confidential Cabinet review and approval is the only significant control or oversight of this program.

Similarly, following approval of assistance, IEF has inadequate processes, controls or documentation supporting ongoing management of loans. Few procedures exist to monitor compliance with loan conditions, repayments, or arrears.

These inadequate policies, processes, controls and documentation for IEF activities represent an inappropriate way to manage public funds.

NSBI has adequate policies, processes, controls and documentation to support its assistance programs of loans, payroll rebates and venture capital investments. Our tests of compliance with policies found few exceptions.

NSBI's program management provides a sharp contrast to IEF. As the administrator of the IEF, the Department of Economic and Rural Development and Tourism should determine whether it should set up a similar system of policies, processes and controls, or alternatively, employ NSBI to process IEF applications and monitor approved assistance.



3 Economic and Rural Development and Tourism: Financial Assistance to Businesses through NSBI and IEF

Background

ECONOMIC AND RURAL DEVELOPMENT AND TOURISM: FINANCIAL ASSISTANCE TO BUSINESSES THROUGH NSBI AND IEF

- 3.1 We first attempted to audit the Industrial Expansion Fund (IEF) and Nova Scotia Business Inc. (NSBI) in 2009. We reported the results of our work in Chapter 2 of our June 2010 Report. At that time, we denied an opinion on certain aspects of our audit because both entities refused to provide the information we required to conclude on the adequacy of financial and program controls and compliance with legislation, regulations and policies related to financial assistance to businesses. In that Report, we made some recommendations based on the limited work we were able to complete.
- 3.2 A new Auditor General Act clarifying this Office’s right of unrestricted access to all records of an audited entity came into effect on December 10, 2010. Subsequently, we revisited our original audit to complete our work as well as to test a sample of more recent transactions. This time we received all available information we needed to carry out our work.
- 3.3 In Nova Scotia, various departments and agencies are involved in business development through the provision of government financial assistance. IEF and NSBI are two organizations through which businesses can access financing and other assistance from the provincial government.
- 3.4 The Industrial Expansion Fund is administered through the Department of Economic and Rural Development and Tourism (Department). It helps businesses to get established or to expand in Nova Scotia by providing assistance through loan financing, loan guarantees and other development incentives. All IEF assistance is approved by Cabinet.

IEF-Approved Financing for the Past Five Years

	2006-07	2007-08	2008-09	2009-10	2010-11
Loans	\$5,790,000	\$19,000,000	\$32,919,000	\$168,400,000	\$18,100,000
Development Incentives	\$8,080,000	\$29,125,950	\$23,895,000	\$14,510,500	\$2,000,000
Equity	\$0	\$10,000,000	\$1,000,000	\$19,600,000	\$4,000,000
Guarantees	\$1,000,000	\$1,500,000	\$3,800,000	\$19,200,000	\$14,500,000
Total	\$14,870,000	\$59,625,950	\$61,614,000	\$221,710,500	\$38,600,000



- 3.5 NSBI is a crown corporation, owned by the Province of Nova Scotia and governed by an independent Board of Directors. It is Nova Scotia's business development agency with a primary goal of expanding business in the province.
- 3.6 NSBI assists business development through various means including loans, payroll rebates, and venture capital investments. Payroll rebates provide companies with a rebate for a portion of their gross payroll provided they meet certain conditions.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

NSBI-Approved Financing for the Past Five Years

	2006-07	2007-08	2008-09	2009-10	2010-11
Loans	\$19,172,500	\$2,750,000	\$3,060,000	\$6,777,500	\$29,190,000
Venture Capital	\$4,000,000	\$3,500,000	\$4,530,000	\$11,228,000	\$5,750,000
Payroll Rebates	\$36,908,540	\$34,189,857	\$15,191,120	\$15,577,682	\$8,479,185
Guarantees	\$4,150,000	\$0	\$0	\$1,000,000	\$5,300,000
Total	\$64,231,040	\$40,439,857	\$22,781,120	\$34,583,182	\$48,719,185

- 3.7 We have not audited the amounts included in the tables in this section.
- 3.8 Our audit covered the period from April 1, 2008 to November 30, 2010. Total financial assistance through IEF during this time totaled \$282.5 million plus \$27 million in loan guarantees. Total financial assistance and guarantees through NSBI during the same period was \$82.6 million.
- 3.9 A 2010 report on the province's website titled *The Way Ahead for Nova Scotia* provides some advice to government on economic development in the province.

Audit Objectives and Scope

- 3.10 As noted earlier, in 2010 we denied an opinion on certain aspects of our audit of financial assistance to businesses through IEF and NSBI. In winter 2011, we completed work on our previous audit as well as updated our testing to include more recent transactions. The audit was conducted in accordance with Sections 18 and 21 of the Auditor General Act and auditing standards established by the Canadian Institute of Chartered Accountants.
- 3.11 The objectives of the audit were to assess IEF's and NSBI's:
- financial and program controls over loans, payroll rebates, development incentives and venture capital investments to business entities; and



- compliance with legislation, regulations and internal policies and procedures in providing loans, payroll rebates, development incentives and venture capital investments.
- 3.12 Generally accepted criteria consistent with the objectives of this audit do not exist. Audit criteria were specifically developed for this assignment. These criteria were discussed with and accepted as appropriate by senior management of the Department of Economic and Rural Development and Tourism, and NSBI.
- 3.13 Our audit approach included an examination of relevant legislation, files and documents as well as interviews with staff. We selected a sample of transactions from our previous audit, as well as a new sample of transactions from June 1, 2009 to November 30, 2010.

Significant Audit Observations

Industrial Expansion Fund

Conclusions and summary of observations

There are few program controls over loans and development incentives at IEF. There are no documented policies or consistent processes for loan and development incentive approval. There is no assurance that potential clients are consistently assessed. We found instances in which the information used to assess and approve loans and development incentives was inadequate. A recently established advisory committee has no oversight role. The Department needs to improve the manner in which funds approved from the Industrial Expansion Fund are handled. Government should consider whether adequate accountability for public funds can be achieved when the only oversight is through Cabinet. Additionally, IEF files are not complete. Much of the information we needed for testing was not in files; investment managers located some of the support we requested in individual email accounts and computers. There are inadequate policies, processes and documentation supporting the management of assistance subsequent to approval. The situation at IEF is in sharp contrast to what we found at NSBI. The Department should consider moving the administration of IEF to NSBI; this entity already has the appropriate governance structure, processes and controls to ensure investments are made in a fair and consistent manner. Alternatively, a similar system of governance, processes and controls, such as what already exists at NSBI, needs to be implemented for IEF.

Assessment and Approval

- 3.14 *No documented approval processes* – IEF has no documented policies or consistent processes for loan and development incentive approval. IEF investment managers assess potential recipients and prepare a report and recommendation and other supporting documentation for Cabinet who are ultimately responsible for approving all financial assistance through IEF.
- 3.15 Deficiencies in the approval process include the following, which we had also identified in our previous Report.
- There is no application system; companies either approach IEF management and discuss the potential for financial assistance or are referred to IEF from other departments.
 - There are no standard checklists to ensure consistent information is collected from all potential loan or development incentive recipients.
 - There is no risk assessment process to ensure all risk areas are considered when assessing loans and development incentives.
- 3.16 Although IEF provides funding to a range of different companies, a standard application process, such as the one used at NSBI, which obtains consistent information on all potential recipients and fully considers the risks involved is a basic program control and an important management tool. This would help ensure fair and consistent treatment for all recipients.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

Recommendation 3.1

The Department of Economic and Rural Development and Tourism should document and implement processes for Industrial Expansion Fund loan and development incentive assessment and approval.

Recommendation 3.2

The Department of Economic and Rural Development and Tourism should develop and implement a risk assessment process to assess potential Industrial Expansion Fund loan and development incentive applicants.

- 3.17 *Little information in files* – Although a central filing system exists, there is very little information in many IEF files. During our testing, we often had to ask individual investment managers for additional information which was not on file. There were instances in which managers had to search through emails and individual computer files to provide support. For one file, it took a week for IEF management to locate the business plan that was used to assess the loan.



- 3.18 Keeping information used to assess loans and development incentives in individual email accounts and computers is risky. Information may not be consistently collected and considered for all applicants. In addition, if there is no evidence on file, it is difficult for senior management to complete any quality assurance processes on the investment managers' work.
- 3.19 The lack of file documentation combined with the lack of application and assessment processes could create problems when training new staff. It also makes it more difficult for investment managers to ensure they have fully assessed possible clients. NSBI uses checklists to ensure all required supporting documents are on file and IEF should institute a similar process.

Recommendation 3.3

The Department of Economic and Rural Development and Tourism should improve the filing system used for the Industrial Expansion Fund. Files should contain all information used to assess potential applicants as well as all relevant correspondence between the Industrial Expansion Fund and the applicant.

Recommendation 3.4

The Department of Economic and Rural Development and Tourism should develop and use standard checklists to ensure consistent information is collected from potential Industrial Expansion Fund loan and development incentive applicants.

- 3.20 *Approval testing* – We selected a sample of 10 approved loans and four approved development incentives to determine if the informal processes as described by management were followed. Although there is no checklist of required information, we examined files to determine whether IEF investment managers obtained adequate information for the assessment.
- 3.21 Our sample included investments selected for testing during our previous audit, as well as investments approved between June 1, 2009 and November 30, 2010. We identified the following issues.
- In one instance, there was no support for the prospective company valuation.
 - In one instance, verification of client-supplied working capital was inadequate because IEF staff based their recommendation for approval on unaudited financial statements.
 - One development incentive which is based on employment levels and wages did not require the company to submit audited reports of employee numbers or payroll levels. Without any external assurance,



payments could be made for employment levels which do not meet the established target.

3.22 A great deal of the supporting information was missing from the 14 files we tested. IEF management were eventually able to locate some of this information in individual staff email accounts or computers. However different investment managers did not always collect a common core of information to assess potential recipients. These issues could be corrected with an improved filing system and the use of checklists.

Recommendation 3.5

The Department of Economic and Rural Development and Tourism should develop a process to ensure the assessment of loans and development incentives through the Industrial Expansion Fund is sufficiently supported. This should include guidelines detailing the appropriate level of assurance required for financial information submitted by the client.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

3.23 *No rejected lists* – There is no list of rejected loan and development incentive applications. While IEF management makes recommendations for approval to Cabinet, potential clients may be rejected directly by management with no involvement of Cabinet. Without a list of rejected applicants and a rejection process, investment managers could reject possible recipients who should be recommended for approval. Failing to maintain a list of rejected applications means it is not possible to determine whether rejections were fair and reasonable.

Recommendation 3.6

The Department of Economic and Rural Development and Tourism should maintain a listing of rejected applications for the Industrial Expansion Fund along with documentation supporting the reasons for rejection. This information should be reviewed by senior management, at least on a test basis, to ensure rejections are appropriate.

3.24 As noted above, Cabinet is responsible for approving all financial assistance through IEF. When we tested the approved loans and development incentives, we also examined the confidential information prepared for Cabinet regarding each transaction. We found that this information provided some analysis of the proposed assistance and discussed potential risks associated with the assistance. However since there are no documented policies detailing what staff are to consider when assessing possible assistance, or how staff are to prepare this information for Cabinet, there is no assurance that transactions recommended to Cabinet have been subjected to a consistent and fair process.



- 3.25 *IEF Advisory Committee* – In May 2010, Cabinet created an external Advisory Committee to give advice to the Minister regarding some of the proposals for financial assistance through IEF. According to its terms of reference (available on the Department’s website), the IEF Advisory Committee is to consist of up to five individuals appointed by Cabinet. The Committee is to provide advice and comments to the Minister regarding whether transactions are “*consistent with meeting the economic development objectives of the Province of Nova Scotia.*” The terms of reference also provide seven high-level general principles regarding government’s economic development policy, including areas such as sustainability, innovation and human resource development. There are no detailed criteria for committee members to review when considering transactions.
- 3.26 The Committee may be asked to provide advice on transactions over \$500,000 or having a budgetary impact of more than \$50,000. If the Minister considers a matter to be urgent he can chose to forego Committee advice and go directly to Cabinet. The Committee has no authority; it is an advisory body only. It does not provide external control or oversight such as a Board of Directors would offer.
- 3.27 The Department began consulting with the Committee on IEF transactions in September 2010. We reviewed one transaction which Advisory Committee members were asked to comment on. The information prepared for the Committee by Department management provided overall information on the company and its current situation. All Committee members expressed some concerns with the transaction; while some members noted there may be good reasons to provide assistance, they also expressed reservations and did not clearly indicate support. One member stated that if this transaction were to be approved, it would be hard to understand the circumstances in which a transaction would be rejected.
- 3.28 Additionally, the documentation prepared for Cabinet regarding this transaction understates these concerns. The information notes only that the Advisory Committee was reluctant to approve the request; it does not provide details of Committee members’ concerns. This transaction was ultimately approved.
- 3.29 Consulting an external Advisory Committee does not provide any oversight of transactions. Effective oversight can help ensure a fair and consistent process is used to analyze assistance proposals; however, the only oversight of IEF transactions is by Cabinet. We believe government needs to consider whether this approach is appropriate and whether it achieves adequate accountability for public funds.

Monitoring and Management

3.30 *Monitoring and repayments* – We examined the processes used to monitor ongoing compliance with loan and development incentive terms and conditions, and loan repayments. Many of the concerns we identified were also reported in our June 2010 Report and are consistent with our findings in other areas.

- IEF has no written monitoring policies to ensure development incentive conditions are met and loan agreements are followed.
- There is no checklist to ensure clients submit all information required by letters of offer.
- IEF has no policies to ensure loan repayments are made on time, identify loans in arrears, and collect past due amounts owing.
- There is no written policy documenting standard processes for the annual review of each IEF loan account or guidelines regarding what information must be reviewed and documented. IEF management informed us that investment managers document the status of loans in an annual write-up. However there is no standard format to ensure consistent evaluation of loan account status. We noted that NSBI has appropriate policies documenting the annual review process and the methods used to ensure investment agreements are followed.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

Recommendation 3.7

The Department of Economic and Rural Development and Tourism should develop processes to ensure Industrial Expansion Fund development incentive conditions are met and loan agreements are followed.

Recommendation 3.8

The Department of Economic and Rural Development and Tourism should implement a checklist to track the status of all information required in Industrial Expansion Fund letters of offer.

Recommendation 3.9

The Department of Economic and Rural Development and Tourism should develop processes to ensure that Industrial Expansion Fund loan repayments are on time.

Recommendation 3.10

The Department of Economic and Rural Development and Tourism should develop processes to identify and follow up Industrial Expansion Fund loans in arrears in a timely manner.



Recommendation 3.11

The Department of Economic and Rural Development and Tourism should determine the standard information which should be examined during Industrial Expansion Fund annual account reviews and develop a process to ensure this information is obtained and documented.

- 3.31 We selected a sample of five loans to determine if IEF was receiving the documentation required by the loan agreement. We found that required reports had not been received in a timely manner for two loans.
- In one instance, a business plan that was required by November 2010 had not been received as of February 2011. Additionally, the required quarterly financial statements had not been received for 2010.
 - In another instance, required annual financial statements were not on file. IEF management informed us that the financial statements were reviewed online. However management has no evidence to support this.
- 3.32 Failure to ensure that required client reports are received in a timely manner could mean IEF management are unaware of client-related issues that may negatively impact loan repayment. As noted above, we have recommended that the Department establish a process to ensure information required by letters of offer is obtained and documented. In addition, management needs to follow up instances in which required information is not received and document steps taken in client files.

Recommendation 3.12

The Department of Economic and Rural Development and Tourism should document follow-up action in client files when information required by letters of offer is not received in a timely manner.

- 3.33 *Loans in arrears* – IEF has no documented policies to determine, assess and follow up loans in arrears. The arrears list is produced by manually entering information from the accounting system into a spreadsheet. Manual processes carry an increased risk of errors and there are no quality assurance processes in place to ensure the arrears report is accurate. In some instances, the report does not list the amount or date of the expected payment which could lead to an undetected late payment or underpayment. Additionally, IEF management has no evidence that this report is produced monthly.
- 3.34 In addition to the problems with the arrears report, there is no process to ensure loans in arrears are followed up in a timely manner.



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- 3.35 We selected three loans identified as past due on IEF's arrears report. For two loans, there was no evidence on file to show whether investment managers had followed up with the recipient. This information was eventually provided to our staff from IEF management email accounts. The other loan did contain documentation of management's follow-up.
 - 3.36 The lack of processes to ensure past due loans are followed up and funds collected means loans in arrears could go undetected. In recommendation 3.10 above, we have recommended that the Department address this situation.

Recommendation 3.13

The Department of Economic and Rural Development and Tourism should put processes in place to ensure an accurate monthly arrears report is prepared by Industrial Expansion Fund staff. This report should be signed off by senior management each month and historical copies should be retained in accordance with government records requirements.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

- 3.37 *Loan/development incentive disbursements* – Once a loan or development incentive is approved, loan security and conditions are verified, either by IEF legal counsel or staff, before loans are disbursed. Disbursements must also be supported by a cheque requisition signed by the Minister, Deputy Minister and IEF management.
- 3.38 We tested seven loans which had been fully or partially disbursed. Loan security and conditions were verified prior to disbursement in all instances. All disbursements were supported by authorized cheque requisitions.
- 3.39 We also selected two development incentive disbursements and found payments were properly supported and authorized by cheque requisitions.
- 3.40 *Loan repayments* – NSBI staff are responsible for recording loan repayments received for IEF loans. We tested 10 IEF loan repayments and found that the payments were properly recorded.
- 3.41 *Legislative compliance* – IEF loans and investments are governed by the Industrial Development Act. The Act broadly defines the terms of financial assistance that IEF can offer; essentially financial assistance may be provided if the Minister deems it appropriate.
- 3.42 We tested 10 approved loans and four approved development incentives and found that all loans and development incentives tested complied with legislative requirements.
- 3.43 *Write-offs* – There is a process to recommend loans for write-off. On an annual basis, staff prepare information on loans which should be written



off. This report is signed by the Deputy Minister and the loans are part of a larger list of write-offs which are approved by Cabinet.

Overall Concerns

- 3.44 We are concerned by the systemic lack of documented policies, processes and basic program controls at IEF. The lack of a documented assessment process combined with the absence of readily available information to support investment recommendations means there is no assurance that IEF management recommends investments to Cabinet in a fair and consistent manner. As Cabinet relies on IEF to conduct necessary due diligence on prospective funding recipients, it is important for IEF to have stronger controls surrounding loan and development incentive assessment and approval. The only oversight of IEF transactions is by Cabinet. The question remains whether this provides adequate accountability for the management of public funds.
- 3.45 Additionally there are inadequate policies, processes and documentation supporting the management of assistance subsequent to approval. This includes monitoring and managing loan accounts, compliance with assistance conditions, and arrears.
- 3.46 Although NSBI and IEF are separate entities, both invest in businesses and assist with economic and business development in Nova Scotia. Unlike IEF, NSBI has well-established policies for lending and other activities. It also has a governance and oversight structure in place through its Board, which is responsible for reviewing and approving transactions over certain limits.
- 3.47 The Department of Economic and Rural Development and Tourism needs to significantly upgrade the administration of the Industrial Expansion Fund. An efficient way to accomplish this would be to transfer responsibility for the administration of the Industrial Expansion Fund to NSBI, since NSBI already has most required processes in place. Alternatively, IEF needs to implement a similar process to the one in place at NSBI. In order to achieve this, the Department needs to implement all of the recommendations in this Chapter.

Recommendation 3.14

The Department of Economic and Rural Development and Tourism should consider transferring the administration of the Industrial Expansion Fund to Nova Scotia Business Inc. to ensure appropriate governance, controls, and policies regarding transactions. Alternatively, the Department should implement a similar process with its own governance, controls and policies. This would be achieved by implementing all of the recommendations in this Chapter.



Nova Scotia Business Inc. (NSBI)

Conclusions and summary of observations

NSBI has adequate financial and program controls and appropriate documented policies and procedures for its lending, venture capital, and payroll rebate activities. These policies are adequate to ensure compliance with legislation and regulations. We found policies were followed in most instances. We did note one instance in which management could have provided more complete information to NSBI's Board regarding a policy issue for a loan approval. As we reported previously in our June 2010 Report, the accounting system is not producing a complete and accurate arrears listing. Manual processes are needed to correct the arrears report which increases the risk of errors.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

- 3.48 *Loan approval* – NSBI has a documented system to receive, assess and approve loan applications. This system complies with legislation. Loans are approved at various levels of the organization based on the total amount of loans outstanding to the client. For example, loans valued up to \$1.25 million are approved by the Investment Committee of the Board, between \$1.25 million and \$3 million must be approved by the Board, and loans in excess of \$3 million are approved by the Governor-in-Council through an Order-in-Council.
- 3.49 We selected a sample of eight approved loans to test compliance with NSBI's policies and procedures; we noted one exception.
- 3.50 When assessing a potential loan, NSBI staff examine five risk elements. Current policy states that if one of these elements is assessed at maximum risk, the loan should not be approved. We found one instance in which a loan was approved despite one risk element rated at maximum. NSBI staff fully assessed the concerns related to this risk and determined that it was still appropriate to recommend to the Board that this loan be approved. The staff-prepared risk assessment, which identified all risks, was included in the proposal summary submitted to the Board; however the proposal did not specifically state that this loan did not comply with existing policy. Management should have ensured Board members were aware of this situation.
- 3.51 NSBI management informed us that they believe this policy should be updated to allow the Board to determine whether it might still be appropriate to provide a loan in certain situations where some risks are assessed as high. This change would make the loans policy consistent with NSBI's venture capital policies in this regard.



Recommendation 3.15

Nova Scotia Business Inc., in conjunction with its Board, should review and update loan policies and procedures as appropriate.

Recommendation 3.16

Nova Scotia Business Inc. should establish a process to ensure that any policy exceptions are separately identified to the approving authority (generally the Board or one of its Committees).

- 3.52 We tested five loan rejections and found all five loans were properly rejected according to policy.
- 3.53 *Legislative requirements* – NSBI’s financial assistance is governed by the Nova Scotia Business Incorporated Act and the Nova Scotia Business Incorporated Financial Assistance Regulations. NSBI has detailed loan policies and procedures that are based on its statutory requirements.
- 3.54 We tested a sample of eight loans and found legislative requirements were followed in all instances.
- 3.55 *Loan repayments* – NSBI has appropriate, documented processes in place regarding the receipt and recording of loan payments. We tested 13 loan repayments and found the process was followed for all payments.
- 3.56 *Monitoring* – NSBI also has appropriate, documented processes in place to monitor the recipient’s ongoing compliance with terms and conditions of loan agreements. At a minimum, there are annual reviews of financial statements and site visits. Although monthly arrears reports are also produced, as discussed below, there are concerns with the accuracy of these reports which may make them less useful from a monitoring prospective.
- 3.57 We selected 15 loan files to test for compliance with monitoring requirements. In one instance, the file did not contain the most recent audited financial statements. All remaining monitoring requirements were met for the sample tested.
- 3.58 *Arrears* – NSBI has an appropriate, documented process to identify loans in arrears and collect overdue amounts owing. We selected a sample of 10 loans in arrears and concluded that appropriate collection activities had been performed by NSBI staff.
- 3.59 As reported in Chapter 2 of our June 2010 Report, NSBI’s accounting system does not produce a complete and accurate arrears listing. NSBI staff manually review arrears reports because the system doesn’t include



loans with principal in arrears or loans which have only been partially disbursed. Manual processes carry a higher risk of error. Our previous Report identified instances in which these manual adjustments contained minor errors. To date, this situation has not been addressed and we have repeated our recommendation.

Recommendation 3.17

Nova Scotia Business Inc. should ensure the accounting system used for loans and other assistance can produce a complete and accurate listing of accounts in arrears.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

- 3.60 *Venture capital approval* – NSBI has appropriate, documented processes for the receipt, assessment and approval of venture capital applications and purchase of equity investments that comply with legislation. Key controls include: review of opportunities with senior management; approval of investments up to \$1.25 million by the Investment Committee of the Board; approval of investments between \$1.25 million and \$3 million by the Board; and approval of investments in excess of \$3 million by the Governor-in-Council through Cabinet.
- 3.61 If an investment appears to be in accordance with NSBI’s mandate, NSBI requests additional information from clients. Information requested is dependent upon the company and a list of requirements is tailored in each instance. Generally, NSBI reviews financial statements and technology and has discussions with staff, customers, and suppliers. Information is compiled to prepare the investment profile and evaluate against the equity investment criteria.
- 3.62 We tested a sample of two venture capital investments and noted that legislative requirements regarding purpose, eligibility, approval process, and terms and conditions were followed in both instances. We also tested two rejected venture capital applications and noted they were appropriately rejected as they did not meet eligibility requirements.
- 3.63 *Monitoring* – NSBI has appropriate, documented processes in place to monitor the recipient’s ongoing compliance with terms and conditions of venture capital agreements. Generally, one member of NSBI management sits on the client’s board for venture capital investments.
- 3.64 We tested five venture capital investments for compliance with the monitoring process and noted that all required monitoring activities had been performed.
- 3.65 *Payroll rebate approval* – NSBI has appropriate, documented processes in place for the receipt, assessment and approval of payroll rebate incentive applications, and to ensure compliance with legislation.



- 3.66 As previously reported, payroll rebate applications are processed by one of two divisions within NSBI depending on the type of assistance requested. In our June 2010 Report, we found that all practices for both types of rebates were not reflected in policy. We recommended that NSBI update its policies. NSBI now has two sets of policies in place that reflect both types of payroll rebates. Both systems are appropriate.
- 3.67 We tested 11 approved payroll rebate applications to ensure compliance with policies and procedures. We noted one instance in which projections and aged accounts receivable and payable listings were missing. In another instance, one file was missing a checklist.
- 3.68 We selected four rejected business financing payroll rebate applications and noted they were appropriately rejected.
- 3.69 Investment attraction payroll rebates are used as an incentive to attract businesses to Nova Scotia. There is no application process; NSBI staff identify and negotiate with potential clients. If those negotiations are not successful, the rebate is not moved forward. We could not test unsuccessful investment attraction rebates because NSBI does not maintain a list of companies with whom negotiations were unsuccessful. It is important to maintain this information to track reasons for businesses not locating in Nova Scotia.

Recommendation 3.18

Nova Scotia Business Inc. should maintain a listing of investment attraction payroll rebates that did not move forward for approval.

- 3.70 *Payroll rebate payments* – NSBI has appropriate, documented processes in place to ensure compliance with terms and conditions of payroll rebate agreements before payroll rebate payments are made.
- 3.71 We tested a sample of 12 payroll rebate payments and found policies were followed in all instances.

APPENDIX I

June 2010 Report Recommendations

Recommendation 2.1

We recommend that Cabinet instruct all departments and agencies of government to comply with all terms of the Auditor General Act and the Public Inquiries Act, cooperate fully with the Office of the Auditor General, and provide the Auditor General with timely and unrestricted access to all information in their possession.

Recommendation 2.2

Nova Scotia Business Inc. should ensure that all practices for both types of payroll rebates are accurately reflected in documented policies and procedures. Policies and procedures should be followed in the review of information and awarding of payroll rebates.

Recommendation 2.3

The Department of Economic and Rural Development should formally document its policies and procedures for the Industrial Expansion Fund. These should include establishing standard application forms, developing a checklist of documents which should be considered and performing a formal risk assessment.

Recommendation 2.4

The Department of Economic and Rural Development should develop formally documented policies and procedures to process loan repayments and for ongoing monitoring of recipients for the Industrial Expansion Fund.

Recommendation 2.5

The Department of Economic and Rural Development and Nova Scotia Business Inc. should ensure the accounting system used for loans and other assistance at the Industrial Expansion Fund and Nova Scotia Business Inc. can produce a complete and accurate listing of accounts in arrears and an aged accounts receivable listing.

Recommendation 2.6

The Department of Economic and Rural Development should establish annual targets which will help assess the effectiveness of financial assistance through the Industrial Expansion Fund. Once established, results against targets should be reported annually.

ECONOMIC AND RURAL
DEVELOPMENT AND
TOURISM: FINANCIAL
ASSISTANCE TO
BUSINESSES THROUGH
NSBI AND IEF

Response: Nova Scotia Business Inc.

Thank you for the opportunity to comment on the 2011 Auditor General's Report on Assistance to Business. Nova Scotia Business Inc. (NSBI) agrees with the report and its recommendations. NSBI is pleased that the report indicates that NSBI has adequate financial and program controls and appropriate documented policies and procedures. We strive to continue to improve our processes and would like to comment on the recommendations.

Recommendation 3.15

Nova Scotia Business Inc., in conjunction with its Board, should review and update loan policies and procedures as appropriate.

Response

NSBI agrees that the loan policies and procedures should be reviewed and updated as appropriate. All policies and procedures should be subject to a review based on changing circumstances and experience gained while the policies and procedures are in use. In the specific instance outlined in the report from the Auditor General NSBI believes its own policy was too rigid with respect to one risk component. The policy should continue to ensure that all relevant risks are assessed, but allow mitigating factors to also play a role in the assessment. In the specific case the policy did not allow for this consideration and the policy shall be updated accordingly.

Recommendation 3.16

Nova Scotia Business Inc. should establish a process to ensure that any policy exceptions are separately identified to the approving authority (generally the Board or one of its Committees).

Response

NSBI agrees with this recommendation. NSBI proposals generally outline any deviations from standard. There is also a compliance review. NSBI will take steps to ensure that exceptions are appropriately identified and not inadvertently missed.

Recommendation 3.17

Nova Scotia Business Inc. should ensure the accounting system used for loans and other assistance can produce a complete and accurate listing of accounts in arrears.

Response

NSBI agrees a system that does not require a manual review of arrears listings is the ideal solution. NSBI has commenced an assessment process and has explored some of the options available for loan portfolio systems. One consideration is that

NSBI has approximately 100 accounts, a relatively small number. The assessment must consider the appropriate use of public funds for this relatively small number of accounts.

While using the current system NSBI will continue with manual checks and balances. There is a monthly review by staff. Reports are provided to management, the Investment Committee, the Audit Committee and the full Board of Directors. The arrears listing is an important aspect of the detailed portfolio valuation process. This process ensures an accurate financial representation in the financial statements and is subject to yearly audit by the financial statement auditor. We remain confident that the public funds used to finance the portfolio are appropriately managed and being subjected to detailed scrutiny throughout the process.

Recommendation 3.18

Nova Scotia Business Inc. should maintain a listing of investment attraction payroll rebates that did not move forward for approval.

Response

NSBI agrees with this recommendation. NSBI has always taken a proactive approach to its business development efforts and uses strong customer relationship processes with potential clients. While information related to the opportunities that did not lead to a company setting up operations in Nova Scotia exists there is no formal listing maintained. It will be relatively easy to track the few instances where NSBI may have lost business, but the difficulty will be in tracing business that may be lost before we are aware of the opportunity. NSBI does agree that maintaining such a list would provide benefit when assessing the effectiveness of the payroll rebate and the investment attraction process in general. NSBI will start maintaining this list.

RESPONSE:
NOVA SCOTIA
BUSINESS INC.

Response: Department of Economic and Rural Development and Tourism

The Department of Economic and Rural Development and Tourism (ERDT) supports the recommendations made by the Office of the Auditor General (OAG) regarding management of the Industrial Expansion Fund (IEF).

While ERDT believes the compensatory controls and processes used to operate the IEF have been sufficient to manage the associated risks, and in particular with the addition of an independent advisory committee, ERDT will implement all OAG recommendations.

The OAG report notes that the IEF is compliant with the Industrial Development Act and that IEF approvals are consistent with legislative requirements.

The OAG acknowledges that an independent IEF Advisory Committee made up of prominent citizens has been established to provide confidential advice directly to the ERDT Minister, and through the Minister, to Cabinet.

Recommendations for IEF financial assistance are made to Cabinet through a Report and Recommendation (R&R) in substantially the same form as that provided to Cabinet by Nova Scotia Business Inc.

Since the OAG's June 2010 report:

1. IEF governance and oversight have been improved with the establishment of the independent IEF Advisory Committee made up Nova Scotians experienced in business and public policy.
2. A dedicated Financial Services Officer and administrative secretary were hired for the IEF in March, 2011.
3. An ERDT re-organization was announced in January, 2011; in part, this will result in a stronger Investment and Trade Branch, under a new Executive Director position.

Since June 2010, Investment staff have been working with the ERDT Measurement and Evaluation Team to develop a performance measurement framework for the IEF, to be piloted in Fiscal Year 2011-2012. The performance measurement framework is being undertaken in five steps:

1. Review of IEF goals.
2. Establish appropriate metrics. Measures are being developed in order to assess desired performance against the goals.
3. Understand performance. Assessment of desired performance with actual achievements.

4. Continuous improvement. Based on an understanding of performance, identify steps for further improvement.
5. Continue to review metrics and performance.

By design, the 2011 OAG review focuses on compliance accountability without a normative baseline. An average reader may incorrectly conclude that the IEF has not been a highly successful economic development tool for more than 50 years.

The IEF is not a standard loan entity and is designed to accommodate a large variety of economic development situations. The core staff of the IEF consists of five persons. One of the IEF's compensating controls is the daily engagement of IEF senior management in all IEF activities and functions.

The latest (2010) IEF annual report clearly outlines how decisions are made. The type of information collected is documented in the annual report under the "How decisions are made" section, and on the ERDT website (<http://www.gov.ns.ca/econ/ief/decisions.asp>).

Additionally:

- The IEF annual report includes audited financial statements; discloses write-offs and incentives earned; and provides the names of recipients and the purposes of the assistance provided.
 - An OIC, generally complemented by a news release, is published with each IEF transaction approved by Cabinet.
 - Over the past 25 years, the IEF has experienced a write-off rate of 2%, excellent results for an economic developmental portfolio.
 - An independent, external consultant was engaged to evaluate the effectiveness of both the IEF and NSBI. The 2008 report by Collins Management was positive.

The independent IEF Advisory Committee provides an impartial analysis of potential investments and provides advice directly to the ERDT Minister. Terms of reference for the committee have been developed and are available on the ERDT website, as is the current membership of the committee (http://www.gov.ns.ca/econ/ief/advisorycommittee/terms_of_reference.asp).

Members serve for a maximum three-year term. The committee meets with the Minister twice annually to provide general advice, as well as undertaking regularly scheduled conference calls to review potential IEF transactions. The committee reviews any transactions over \$500,000 in value or any transaction that has an operating budget impact of more than \$50,000.

RESPONSE:
DEPARTMENT
OF ECONOMIC
AND RURAL
DEVELOPMENT
AND TOURISM

Proposed transactions are presented to the IEF Advisory Committee by ERDT's Investment staff. Staff presentations contain typical criteria by which to assess potential transactions:

- Company
- Nature of request
- Nature of business
- Purpose of request
- Relevant relationships (including nature of management, ownership, all current financial commitments to commercial, government, others)
- Proposed security
- Financial risk assessment
- Anticipated budget impacts to IEF
- Assessment of any other risk
- Summary of current situation for business

Investment staff respond to questions and observations from committee members, after which committee members provide their comments and assessment of the proposed transaction to staff and directly to the Minister through a confidential e-mail account. The information provided to the Advisory Committee is included as an appendix to the Report and Recommendation submitted to Cabinet.

Transaction risks are assessed by IEF staff and reviewed by the IEF Advisory Committee. The Cabinet is advised of the risks in the Report and Recommendation.

The IEF has been reviewed on many occasions. In his July 2010 report "*Invest More, Innovate More, Trade More, Learn More: The Way Ahead for Nova Scotia*," Dr. Donald Savoie said:

"The differences between IEF and NSBI are sharp: IEF tends to focus on existing businesses in the province, relies on an assortment of instruments from cash incentives to loan guarantees, remains highly flexible to accommodate different circumstances, looks largely to the manufacturing sector, and continues to focus on both urban and rural Nova Scotia. In contrast, for the most part, NSBI looks to attract outside businesses to Nova Scotia, looks to payroll rebates as its key instrument, operates according to program guidelines, and looks mainly to the IT, financial, and aerospace sector. NSBI has a very low risk tolerance, while IEF is expected to respond quickly to emerging economic opportunities."

Dr. Savoie went on to say:

“I can think of no better home for IEF than Economic and Rural Development (ERD). The goal is to build both ERD and NSBI’s strengths. NSBI can never be the “only” economic development agency in Nova Scotia ... NSBI has a proven track record in marketing Nova Scotia and in pursuing and attracting business investments from outside the province. ERD, meanwhile, is connected to the business community in every community in the province through the province’s political and public administration processes. It is no accident that when the government introduced the Manufacturing and Processing Investment Credit (now called the Productivity Investment Program), it was placed in ERD, not NSBI.”

He concludes: *“Managing the relationship between ERD and NSBI needs to rest on the recognition that both agencies have an important role to play in the economic development field...”*

ERDT will implement the recommendations from the Office of the Auditor General to further strengthen the position of the IEF within the economic development field in Nova Scotia.

RESPONSE:
DEPARTMENT
OF ECONOMIC
AND RURAL
DEVELOPMENT
AND TOURISM