

ENTERPRISE CAPE BRETON CORPORATION

SPECIAL EXAMINATION REPORT

**Presented to the
BOARD OF DIRECTORS**

25 October 2004

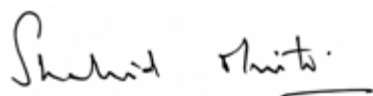
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To: The Board of Directors of Enterprise Cape Breton Corporation.

I—SPECIAL EXAMINATION OPINION

1. Under Part X of the *Financial Administration Act* (FAA), Enterprise Cape Breton Corporation is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.
2. The FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every five years.
3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination, from 20 November 2003 to 30 June 2004, there were no significant deficiencies in the systems and practices examined.
4. We based our examination plan on a survey of the Corporation's systems and practices, which included a risk analysis. We submitted the plan to the Audit Committee of the Board of Directors on 7 May 2004. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.
5. The plan also included the criteria that we selected specifically for this examination, in consultation with the Corporation. The criteria were based on our experience with performance auditing. Our choice of criteria was also influenced by legislative and regulatory requirements, professional literature and standards, and practices followed by the Corporation and other organizations. The systems and practices we examined and the criteria we used are listed in Appendix A.
6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we relied on the work of the Corporation's internal auditor in the areas of project selection, assessment and approval.
7. In our opinion, based on the criteria established for this special examination, there is reasonable assurance that there were no significant deficiencies in the systems and practices we examined.
8. The rest of this report provides an overview of the Corporation and more detailed information on our examination findings.



Shahid Minto, CA
Assistant Auditor General
for the Auditor General of Canada

Halifax, Canada
30 June 2004

II—OVERVIEW OF ENTERPRISE CAPE BRETON CORPORATION

Cape Breton's Economy

9. As part of its planning process, Enterprise Cape Breton Corporation conducts an economic environment scan. The Corporation's most recent scan made the following observations.
10. The Cape Breton economy continues to adjust to the loss of the coal and steel industries. The labour markets continue to adjust to an excess supply and a declining population.
11. The population of Cape Breton is about 149,000. Two thirds of the population live in the area of the Cape Breton Regional Municipality. The population of Cape Breton declined seven percent between census years 1996 and 2001. It is forecast that this decline will continue for the 2006 census.
12. The population decline includes an out-migration of youth. This creates special challenges as the future of the Island's workforce depends in part on the youth staying in Cape Breton.
13. The unemployment rate in Cape Breton remains higher than the provincial and national rates. For 2003 it was 16.2 percent, as compared to 9.3 percent for Nova Scotia and 12 percent for Canada.
14. In 2003, the labour force on Cape Breton Island was about 63,000 with 52,700 employed—42,200 on a full-time basis and 10,500 on a part-time basis.
15. The average 2002 income per wage earner in Cape Breton was \$23,189, as compared to \$27,614 for Nova Scotia and \$32,946 for Canada.

Context

16. The Government of Canada's approach to economic development in Atlantic Canada is one of effective co-operation and partnership with provincial, regional and local economic development organizations. In Cape Breton and the Mulgrave area, economic development programming is provided by three principal federal entities—the Atlantic Canada Opportunities Agency (ACOA), Enterprise Cape Breton Corporation (ECBC) and the Cape Breton Growth Fund Corporation (CBGFC).
17. The Atlantic Canada Opportunities Agency was created in 1987 to co-ordinate and carry out the federal government's economic development initiatives in Atlantic Canada. It has a mandate to increase opportunity for economic development and, more particularly, to enhance the growth of earned incomes and employment in the region.
18. In December 1988, the mandate, powers, operations and programs of the former Industrial Development Division of the Cape Breton Development Corporation were subsumed by Enterprise Cape Breton Corporation.
19. ECBC became responsible for the delivery of ACOA programs on Cape Breton Island and the Mulgrave area in 1995.
20. In January 1999, the Government of Canada announced its decision to phase out the Cape Breton Development Corporation's Phalen coal mine and privatize its assets. To offset the economic impact of this decision, the federal government also announced it would provide \$68 million to assist with the adjustment of the local economy through the promotion of sustainable, long-term economic development for Cape Breton Island. CBGFC is a wholly owned subsidiary of Enterprise Cape Breton Corporation and

has the same mandate. CBGFC will receive total funding of \$91 million, including \$12 million from the Province of Nova Scotia. When CBGFC has committed its available funding it will become part of ECBC.

21. In addition to its own programs and activities, Enterprise Cape Breton Corporation delivers ACOA and CBGFC programs in Cape Breton and the Mulgrave area on behalf of these organizations. The service delivery requirements are set out in a memorandum of understanding with each organization.

22. Historically, the number of projects and the dollars managed by the Corporation for ACOA programs in Cape Breton is significantly higher than those provided under ECBC's programs and activities.

Legislative Mandate

23. Pursuant to Part II of the *Government Organization Act, Atlantic Canada, 1987 (ECBC Act)*, Enterprise Cape Breton Corporation has a broad mandate:

The objects of the Corporation are to promote and assist, either alone or in conjunction with any person or the Government of Canada or of Nova Scotia or any agency of either of those governments, the financing and development of industry on the Island of Cape Breton to provide employment outside the coal producing industry and to broaden the base of the economy of the Island.

The *Act* specifies that the corporation's mandate includes Cape Breton Island and a portion of mainland Nova Scotia in and around the Town of Mulgrave.

24. Under its enabling legislation the Corporation has the power to:

- lend money with or without security and with or without interest; make a grant; invest in the shares or securities or to provide a guarantee to those it considers likely to make a substantial contribution to the industrial development of Cape Breton;
- purchase, sell, lease or otherwise acquire/dispose of lands on Cape Breton Island;
- hold mortgages and liens to secure payment of any lands sold or disposed of; and
- advertise industrial opportunities on Cape Breton Island, publish and distribute brochures and materials and make contributions to the effective promotion of the economic development of the Island.

Mission and Strategic Priorities

25. The Corporation states its mission as the following:

Enterprise Cape Breton Corporation is the principal federal government organization for economic development in Cape Breton. In partnership with all levels of government, the private sector and other community stakeholders, ECBC will use its broad and flexible powers to assist, promote and coordinate efforts that foster an environment supportive of the generation of wealth to effect sustainable job creation throughout Cape Breton Island and Mulgrave.

26. The Corporation has six strategic priorities. The priorities, with their key objectives, are identified in the 2004-2005—2008-2009 Corporate Plan Summary as follows:

- Delivery/Service Agent for Government Services—to deliver programs and services, on behalf of government organizations, in an effort to increase opportunity for a coordinated approach to

socio-economic development on Cape Breton Island and, specifically, to enhance the growth of both earned incomes and employment opportunities in the region.

- Support to Business—to grow the economy by encouraging private-sector investment in projects that enhance the competitiveness of commercial enterprises and increase trade opportunities to produce long-term, sustainable jobs.
- Support to Communities—to help communities plan and implement community development projects that have a direct link to long-term, self-sustaining economic policy.
- Investment—to attract new business investment to Cape Breton Island
- Advocacy—to advocate for Cape Breton Island interests, priorities and concerns in government decisions.
- Policy and Research—to help provide a sound basis for the Corporation's policies, priorities and programs.

Operating Environment

27. Historically, the economy of Cape Breton has been dependent on resource-based industries, particularly coal mining, steel manufacturing and the fishery. These traditional industries have gone through long-term structural downsizing and closure. The Cape Breton economy continues to undergo transitional pains as it moves to a new economy.

28. Other organizations contribute in varying degrees to economic development in Cape Breton. These include the provincial government, the Atlantic Canada Opportunities Agency, Human Resources and Skills Development Canada, the Business Development Bank of Canada and Export Development Canada. There are also numerous smaller organizations that provide some form of economic development in Cape Breton. These include two regional development authorities, community business development corporations and local non-governmental organizations. Much of the funding for these agencies is provided by the federal and provincial governments.

29. The extent of coordination and collaboration between the Corporation and these organizations to provide an integrated approach toward economic development in Cape Breton varies among organizations.

30. In addition to providing direct financial assistance and in keeping with its broad mandate the Corporation actively acquires, manages and disposes of real property holdings in order to provide economic development incentives. The Corporation currently owns and manages several properties, some of these are rental properties and others are held for potential transfer or sale as incentives for economic development opportunities.

III—FINDINGS

31. As stated in our special examination opinion, we concluded that during the period under examination from 20 November 2003 to 30 June 2004, the systems and practices of ECBC were designed and operated in a way that provided reasonable assurance that assets were safeguarded and controlled, resources managed economically and efficiently, and operations carried out effectively.

32. Throughout this report we have identified various opportunities to enhance the quality of these systems and practices.

Governance and Corporate Planning

33. **Improved governance.** Since the last special examination, the Corporation has improved its governance and corporate planning processes. In 2001, the Corporation engaged the Conference Board of Canada to assist in developing a corporate governance framework.
34. ECBC has adopted many good practices for effective corporate governance. These practices include communication with the shareholder and stakeholders, governance training for Board members; Board member profiles; responsibility frameworks for the Chair, the Board and management; a conflict of interest code for Board members, and an annual assessment of the performance of the Chief Operating Officer by the Board.
35. The Corporation's 2003-04 annual report presents a self-assessment of its governance practices against the Treasury Board guidelines for governance in Crown corporations. The self-assessment found that ECBC complies with the guidelines.
36. **Structured corporate planning process.** The Corporation has developed and implemented a structured process for its corporate planning cycle. The process includes consultations with the Corporation's stakeholders. The Board members are active in setting strategic direction, participate in the planning process, and review and approve the plan.
37. The corporate planning process established measurable goals and objectives with effective strategies to achieve corporate objectives.
38. **Risk management policy and framework.** Corporate risk management is a process applied in setting strategies across a corporation. It is designed to identify potential risks that may affect the corporation, manage risk within the corporation's risk tolerance, and provide reasonable assurance on the achievement of the corporation's objectives. A corporate risk management policy and framework would describe how senior management and the Board gain knowledge and assurance that risks are being identified, evaluated and managed appropriately.
39. ECBC has some of the elements of risk management in place, including assessment of risk for individual projects and Board approval for policy changes. However, it could benefit from a formal corporate risk management policy and framework.
40. In its 2003-04 annual report, the Corporation indicated that it will develop a risk management framework that incorporates the risk management practices currently in place and identifies additional management strategies.

Reporting Performance

41. **Performance management framework developed.** Since the last special examination, the Corporation, in consultation with the Treasury Board Secretariat, has developed and implemented a performance management framework to measure its performance against its objectives. The framework is updated annually in conjunction with the corporate planning process. The Corporation is now in the final year of a five-year plan. A comprehensive review of the performance management framework is planned for this year.
42. **Measurable targets.** The Corporate Plan Summary includes performance targets (outputs). Annual and five-year targets are also included for strategic priorities, except for the strategic priority Delivery/Services Agent for Government Services.
43. This strategic priority consists of the delivery and support of the programs of the Atlantic Canada Opportunities Agency and the Cape Breton Growth Fund Corporation. The Corporation is currently

exploring opportunities to expand its role as a provider of federal socio-economic development programs and services in Cape Breton.

44. The Corporation has identified one of the main objectives of this initiative as cost effectiveness by avoiding duplication and overlap in program delivery. However, ECBC has not developed measures and targets to evaluate its role as service provider to ACOA and CBGFC.

45. **Performance monitored and reported.** The Corporation monitors and reports on performance against targets included in the Corporate Plan Summary. It prepares quarterly and annual performance management reports for senior management and the Board of Directors. It also reports on corporate performance to Parliament each year through the annual report.

46. The Corporation has met or is on track to meet its five-year targets to 2004-05. Appendix B provides details on performance measures for the Corporation's strategic priorities.

47. **Results chain.** When considering the performance of a program, a logic model or results chain is often developed. This is usually in the form of a diagram and describes how activities undertaken produce a variety of outputs, which in turn result in a chain of subsequent outcomes that are expected to occur.

48. The Corporation could benefit from a results chain that clearly links its mandate, strategic priorities, operational activities, measures of progress and performance targets.

Project Selection, Assessment, Approval and Monitoring

49. **Improved policies and practices.** The 1999 special examination report made a number of observations on program management including project approval policies, and the measuring and monitoring of project results. The present examination found that since the last special examination the Corporation has improved the way it selects, assesses and approves projects.

50. For the fiscal year ended 31 March 2004, the Corporation approved 9 commercial projects for total ECBC funding of \$1.8 million and 17 non-commercial projects for ECBC funding of \$1.2 million. In addition, under its festivals and events program, ECBC approved 47 projects for total funding of \$200,000.

51. An audit sample of 8 projects was selected from these 26 commercial and non-commercial projects. This sample represented audit coverage of 73 percent of the ECBC funding approved in 2004 for commercial and non-commercial projects.

52. Detailed audit procedures were conducted on these projects. Each project met the audit criteria for selection, assessment and approval, including mitigation of environmental risks and contributing to achievement of ECBC's strategic priorities, with due diligence and in a timely manner.

53. The monitoring and evaluation of commercial projects was completed on a timely basis. They may not have been conducted on a timely basis for non-commercial projects, as tracking codes have not been properly maintained. We understand that management is aware of this problem with non-commercial projects and has initiated steps to correct it.

54. **Targets for commercial and non-commercial support.** In its Corporate Plan Summary, the Corporation set a target of 40 percent commercial and 60 percent non-commercial for assistance under ECBC programs. The targets for 2003-2004 were 50 percent commercial and 50 percent non-commercial. For years 2002-2003 and prior, the targets were 70 percent commercial and 30 percent non-commercial.

55. The changes in these targets represent a significant shift in support from commercial projects to non-commercial projects.

56. The Corporation established an in-house internal audit group in April 2000. Since that time, the audit group has conducted project evaluations on ECBC commercial and non-commercial projects approved from 1 April 2001 to 31 March 2004, with satisfactory results.

57. In addition, the audit group has conducted payments and compliance reviews of commercial and non-commercial projects for the fiscal years ended 31 March 2002, 2003 and 2004, also with satisfactory results.

Services Provider

58. Delivery/Service Agent is one of the Corporation's strategic priorities in its Corporate Plan Summary. This strategic priority consists of three activities—providing services to the Atlantic Canada Opportunities Agency, acting as the secretariat for the Cape Breton Growth Fund Corporation, and commencing a dialogue on an Alternative Service Delivery Model: Pilot Project for Canada.

59. ECBC has not established performance measures or targets of performance for this strategic priority. Without performance measures or targets, the Corporation is unable to determine if the services it provides are efficient and effective.

60. Memoranda of Understanding (MOU) for services provided to the Atlantic Canada Opportunities Agency and the Cape Breton Growth Fund Corporation are in place. The MOUs specify the services that Enterprise Cape Breton Corporation provides, the standards for providing the services and the process to determine cost-recovery amounts. The Corporation is in compliance with the terms of the Memoranda of Understanding.

61. In its Corporate Plan Summary, the Corporation states that it plans to become the lead provider of federal socio-economic development programming and services for Cape Breton.

62. With an expansion of its role of providing services to other organizations, it is important that ECBC measure and report on the effectiveness, efficiency and quality of services it provides.

Real Property Management

63. **Real property portfolio.** ECBC's enabling legislation gives it the power to purchase, sell, lease or otherwise acquire/dispose of lands on Cape Breton Island. The Corporation has acquired properties in several ways. Some properties were transferred from predecessor corporations while other properties were purchased for \$1 or at fair-market value.

64. The Corporation owns 10 properties. The real property portfolio includes commercial rental properties, vacant land and commercial buildings held for resale. The estimated value of the portfolio is \$5 million, with the Silicon Island property representing \$4.2 million of the total.

65. On 1 April 2004, ECBC transferred all of its real property holdings to DARR (Cape Breton) Ltd, a wholly owned subsidiary.

66. The DARR Board comprises three directors—the Vice-President of ECBC, a member of ECBC's senior management team and a member of the Board of Directors of ECBC. DARR prepares a formal report for presentation at the ECBC Board meetings. The report provides details of real property activities since the previous meeting.

67. **Policies and procedures** With the small number of real property holdings and the few ECBC employees involved in this area, current management practices, procedures and information systems have tended to be informal.

68. The Corporation does not have policies and procedures to ensure that the acquisition of real property is characterized by prudence and integrity and reflects a commitment to the environment and sustainable

development. Nor does the Corporation have an acquisition policy that requires environmental assessments to be completed before finalizing an acquisition.

69. The history of real property holdings has been documented on an ad-hoc, as-needed basis. The Corporation does not have a real property management framework, including an information system to capture the details for each property.

70. The Treasury Board's Real Property Management Framework Policy, applicable to federal departments, requires development and implementation of a framework for managing real property. Departments are required to develop, maintain and apply suitable structures, policies and practices, as well as organizational authorities and the technical, administrative and financial systems appropriate to manage real property in their custody.

71. Although not required to follow this Treasury Board Policy, ECBC could consider the policy in developing a corporate real property management framework.

72. The policies and supporting guides would provide due diligence guidance to the Board of Directors, as ECBC considers expanding its real property holdings, including acquiring the lands not suitable for coal mining currently owned by Cape Breton Development Corporation.

Loan and Investment Portfolio Management

73. **Loan and investment balances.** The carrying value of loans is \$3.7 million and equity investments are valued at \$0.5 million.

74. Forgivable loans of \$170,000 and conditionally repayable contributions totalling \$21.2 million are not included in the loan and investment balances. It is the Corporation's accounting policy that the forgivable portion of loans and conditionally repayable amounts are charged to operations when the loans are issued. These amounts become receivable only if terms and conditions of the agreements are not fulfilled. These agreements are monitored for compliance with terms and conditions.

75. **Laurentian Energy Corporation—Sydport Industrial Park.** Included in conditionally repayable contributions is \$3.1 million for the 1999 sale of the Sydport Industrial Park to Laurentian Energy Corporation. The purchase agreement set the purchase price at \$3.1 million with interest calculated at 6.75 percent per year.

76. The purchase price is conditionally repayable upon the achievement of performance targets for creation of new jobs and capital investment in the industrial park to be achieved by 15 September 2004.

77. ECBC is in the process of determining if the conditions of the agreement have been met by the purchaser, what options are available if the conditions have not been met, and what course of action it will take.

78. **Monthly monitoring.** The status of loans and equity investments is monitored regularly. Information such as portfolio trial balances, aged accounts receivables, past-due loans and receivables due are reviewed on a monthly basis.

79. A monthly monitoring report containing detailed information on all accounts that are overdue by one day or more is reviewed by senior management to ensure that action is taken on the delinquent accounts.

80. **Annual assessment for impairment.** Senior management conducts annual impairment assessments and risk reviews of all outstanding loans, equity investments and repayable contributions. It makes recommendations for impairment to the Audit Committee of the Board of Directors.

81. **Impairments and write-offs approved by the Board of Directors.** The Audit Committee makes recommendations on impairments and write-offs to the Board of Directors. These are then approved by a Board resolution.

82. **Portfolios managed with due diligence.** The Corporation has systems and practices in place to ensure that loan and investment portfolios are managed with due diligence. Loans and investments are recorded, classified and reported on a timely basis. Key procedures include annual risk assessments and regular monitoring of loans and investment accounts. In addition, delinquent accounts are monitored by senior management on a monthly basis and timely action is taken, including rescheduling, set-off by the Crown or write-off.

The Way Forward

83. Historically, the economy of Cape Breton has been dependent on resource-based industries. These industries have gone through long-term structural downsizing and closure and Cape Breton is now undergoing transition to a new service-based economy.

84. The Corporation is in the last year of a five-year performance plan with targets put in place in 2000. These targets include creation of 600 jobs, \$35 million in leveraged funds, and \$10 million in new export sales. At the end of year four, the Corporation is on track to meet or exceed its five-year targets.

85. ECBC has prepared terms of reference for outside consultants to review the performance management framework implemented in 2000, examine the Corporation's approach to performance monitoring and provide recommendations on how to improve the framework. New five-year targets will be presented in the next Corporate Plan.

86. In discussions, the Vice-President stated that ultimate success would be for Cape Breton to achieve employment rates in Cape Breton that reach or exceed the rate for the province of Nova Scotia by 2014.

87. As a strategic priority for the Corporation, the Corporate Plan Summary proposes that ECBC becomes the lead provider of federal socio-economic development programming and services for Cape Breton. The Corporation currently has a MOU with Cape Breton Development Corporation to collaborate on the transfer of properties with economic development potential from CBDC to ECBC in a timely and efficient manner.

88. ECBC proposes to expand its role and consolidate the federal government's socio-economic programs on Cape Breton Island. The Corporation has not yet established a date by which it will accomplish this.

APPENDIX A—Key Areas Examined and Related Examination Criteria

KEY AREAS	EXAMINATION CRITERIA
<p>Governance</p> <ul style="list-style-type: none"> • Strategic and corporate planning • Corporate governance • MOUs for ACOA & CBGFC • Accountability framework 	<ul style="list-style-type: none"> • The Corporation should establish and implement an effective governance framework and strategies/ practices consistent with achieving its mandate. • The Corporation should ensure it provides coordinated, effective and efficient services for the organizations it provides services for under memoranda of understanding.
<p>Performance</p> <ul style="list-style-type: none"> • Performance measurement and reporting framework 	<ul style="list-style-type: none"> • The Corporation should establish measure and report on appropriate performance indicators that evaluate the effectiveness and efficiency of its operations, assist in decision making, and ensure accountability.
<p>Projects</p> <ul style="list-style-type: none"> • Project selection, assessment and approval process • Project monitoring and evaluation procedures 	<ul style="list-style-type: none"> • The Corporation’s policies, practices and procedures for project selection, assessment approval, monitoring and evaluation should ensure due diligence, that projects are consistent with the mandate and reflect a commitment to the environment and sustainable development.
<p>Assets</p> <ul style="list-style-type: none"> • Asset management procedures: <ul style="list-style-type: none"> - real property - loan portfolio - investment portfolio 	<ul style="list-style-type: none"> • The Corporation should manage real property holdings, loan, repayable contribution and equity investment portfolios with due diligence, in a manner consistent with the corporate mandate, and to reflect a commitment to the environment and sustainable development.

APPENDIX B—Performance Measures by Strategic Priority

Strategic Priority and Performance Measures	Annual Target	Year 4 2003-04 Annual Performance	5-Year Target	Progress to Year 4 against 5-Year Target
Support to Business				
Estimated number of jobs created	50	404	500	168%
Dollar value of leveraged funds	\$ 3M	\$ 3.3M	\$ 35M	157%
Dollar value of new export sales	\$ 2M	\$.5M	\$ 10M	1,402%
Support to Communities				
Dollar value of leveraged funds	\$ 1M	\$ 1.7M	\$ 5M	290%
Community Adjustment fund				
Dollar value of leveraged funds	-	\$ 16.M	\$ 8M	246%
Trade & Investment				
Number of new exporters	5	-	25	96%
Number of exporters that increase export sales	10	-	50	40%
Dollar value of contracts resulting from trade activity	\$ 2M	\$ 16.0M	\$ 10M	617%
Advocacy				
Dollar value of incremental resource commitments	\$.15M	\$ -	\$.3M	51%
Policy and Research				
Research studies	8	7	40	80%

Note:

The Corporation has established five-year targets for each performance measure. Fiscal year 2003-04 is the fourth year of the five-year plan. This table provides the actual performance results for fiscal year 2003-04 compared with the annual targets for the year. It also provides the Corporation's progress against the five-year targets at the end of the fourth year.