BUSINESS DEVELOPMENT BANK OF CANADA

SPECIAL EXAMINATION REPORT

PRESENTED TO THE BOARD OF DIRECTORS

15 JULY 2004

Auditor General of Canada
Vérificatrice générale du Canada

KPMG

15 July 2004

To the Board of Directors of the Business Development Bank of Canada

We have completed the special examination of the Business Development Bank of Canada in accordance with the plan presented to the Audit Committee of the Board of Directors on 21 October 2003. We are pleased to provide our report on the special examination, as required by section 139 of the *Financial Administration Act*.

We would like to express our appreciation to the Board, management, and staff of the Bank for their excellent cooperation and assistance during the examination.

Yours sincerely,

Sheila Fraser

KPMG LLP

Sheila Fraser, FCA
Auditor General of Canada

KPMG LLP

Attachment

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To the Board of Directors of the Business Development Bank of Canada :

SPECIAL EXAMINATION OPINION

1. Under Part X of the *Financial Administration Act* (FAA), the Business Development Bank of Canada 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 October 2003 to April 2004), there were no significant deficiencies in the systems and practices we 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 October 21, 2003. 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 included the criteria for the special examination 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 internal audits of strategic and operational planning, lending activities, and consulting services.

7. In our opinion, based on the criteria established for the 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 and conclusion.

Sheila Fraser

KPMG LLP

Sheila Fraser, FCA
Auditor General of Canada

KPMG LLP

Ottawa, Canada
30 April, 2004

OVERVIEW OF THE BUSINESS DEVELOPMENT BANK OF CANADA

9. The Business Development Bank of Canada (the Bank or BDC) was established in 1995 by the *Business Development Bank of Canada Act (*Act*)*. The Act streamlined and modernized the mandate and activities of the Bank's predecessors, the Federal Business Development Bank (established in 1975) and the Industrial Development Bank (1944). The Bank is accountable to Parliament through the Minister of Industry.

10. The public policy mandate of the Bank is to support Canadian entrepreneurship: it does so by providing financial and consulting services with particular consideration to the needs of small and medium-sized enterprises (SME). The Bank also has a commercial mandate: it is required to generate a return on equity at least equal to the federal government's long-term cost of capital. It also has to maintain sufficient capital to withstand unfavorable economic conditions without the help of government funding and operate within capital requirements established by the Treasury Board of Canada.

11. Following the adoption of the Act, the Bank has worked to transform itself from a "lender of last resort to a "complementary lender" a commercial financial institution offering products and services that complement those offered by traditional financial institutions. In keeping with its public policy role of enhancing the competitiveness of Canadian entrepreneurs, the Bank aims to fill four gaps in the financing available in the financial market:

- risk gap (financing of riskier enterprises)
- size gap (financing of small and medium-sized enterprises)
- flexibility gap (offering flexible terms and conditions)
- knowledge gap (financing of knowledge-based industries)

12. In accordance with the Act, a review of the Bank's mandate was undertaken in 2000 by a committee of representatives from Industry Canada, the Department of Finance, the Treasury Board Secretariat, and the Bank. In 2001, the Minister of Industry tabled a report in Parliament entitled "Supporting Small Business Innovation: Review of the Business Development Bank of Canada.*"* The report concluded that the financing gaps when the Bank was created in 1995 still existed. Small and medium-sized enterprises, particularly young, fast–growing, knowledge-based firms, still had trouble getting the financing they needed to grow. The report recommended that the Bank's mandate be reconfirmed and the Act remain unchanged. In 2002, the House of Commons Standing Committee on Industry, Science and Technology endorsed that recommendation and the relevance of the Bank's public policy role as a complementary financial institution. The Act requires that the Bank's mandate be reviewed again in 2011.

Mission, vision and corporate objectives

13. The Bank's mission, vision, and corporate objectives as approved by the Board of Directors are stated in the 2004-2008 Corporate Plan:

<u>Mission</u> To help create and develop Canadian small and medium-sized business through timely and relevant financial and consulting services.

<u>Vision</u> To make a unique and significant contribution to the success of dynamic and innovative entrepreneurship for the benefit of all Canadians.

Corporate Objectives

- **Clients** - Create a unique and valued relationship with Canadian entrepreneurs to support the creation of their businesses and accompany their growth.
- **Employees** - Foster a culture of engagement, learning and growth.
- **Efficiency** - Establish effective and efficient processes to support local market understanding.
- **Financial** - Be profitable to grow while fulfilling its public policy mandate, and generate a return on equity at least equal to the government long-term cost of funds.

14. The Bank employs approximately 1,400 people. Customer service is provided mainly through three regions, more than 80 branches across Canada, and BDC Connex, a virtual branch. All branches offer lending services, and many offer consulting services. Venture capital operations are split by specialty between the Bank's headquarters in Montreal and five offices.

Business solutions

15. During fiscal year 2002-03, the Bank reviewed all the products it offers to clients and then modified the product line to provide four business solutions aimed at meeting the needs of its clients at different stages of their growth:

- **Term lending,** with flexible terms to undertake various commercial projects (expansions, business acquisitions, and fixed assets acquisitions) and to increase working capital. These loans offer a larger percentage of asset financing over a longer period than normally offered by commercial financial institutions.
- **Productivity Plus loans** to finance equipment purchases of up to $5,000,000. These loans can cover 100 percent of the equipment's purchase value plus up to 25 percent to a maximum of $500,000 for costs such as installation of the equipment and employee training.
- **Co-Vision loans,** a new solution to fill the gaps in financing the start-up of a business in the manufacturing, wholesale, transport and service sectors. These loans are aimed at supporting entrepreneurs who need up to $100,000 for equipment or working capital.
- **Innovation loans** to support innovation strategies with up to $250,000 in working capital to develop new products; train staff; adopt industry standards; undertake research and development; or purchase, develop, or transfer new technology, for example.

16. The Bank also has a mandate to participate in the venture capital market. It provides start-up businesses with venture capital in high-technology industries such as life sciences, information technology, advanced technologies and telecommunications. It usually invests in enterprises for a term of four to seven years either directly or indirectly, through vehicles such as specialized funds, technology seed funds, and "funds of funds." The Bank also offers subordinated financing, a hybrid instrument combining elements of debt financing and venture capital and usually sought by enterprises that have little or no collateral but do not want to dilute their ownership. The maximum financing available was recently increased from $3 million to $5 million.

17. Finally, the Bank offers various types of consulting services to support small and medium-sized enterprises. Through a network of consultants, the Bank provides advice in the areas of growth management, quality assurance, innovation and productivity enhancements and e-business.

Financial position and results of operations

18. The Bank operates on a financially self-sustaining basis, in accordance with commercial principles; it receives no appropriations from Parliament to fund its operations and consequently must assess credit and market risks and price its products accordingly. Operations are funded by issuing debt instruments in international capital markets and by a range of cash management activities. Its debt instruments are secured by the Government of Canada. The Act allows it to borrow 12 times its equity with the approval of the Minister of Finance. From time to time, the Bank receives equity infusions from the Government of Canada as its sole shareholder. For the year ended 31 March 2003, the Bank realized a net income of about $32 million.

19. **Loan portfolio.** At 31 March 2003, the portfolio of outstanding loans amounted to about $6.3 billion, net of a $426 million allowance for credit losses. The portfolio comprised loans to some 22,000 clients, the majority of them term loans. More than 60 percent of clients had loans balances under $250,000, representing less than 20 percent of the portfolio's total value. Net income from loans operations amounted to $94.5 million. In its 2004-2008 Corporate Plan, the Bank indicated that new loans were expected to produce an annual growth of 7 percent in the loan portfolio; by the end of fiscal year 2007-08, the portfolio should reach $10 billion in loans to 30,000 Canadian entrepreneurs.

20. **Venture capital portfolio**. The portfolio amounted to about $302 million, invested directly in about 150 companies and in 10 investment funds. The total value of venture capital investments increased sharply in the last five years; the Bank's net income from venture capital operations, though averaging positive over that period, has been volatile from year to year. The Bank incurred a loss of $59.5 million on its venture capital business in fiscal 2002-03.

21. Appendix B presents a summary of key performance measures and selected financial data for the last five years. New loans authorization statistics are provided in Appendix C.

FINDINGS

Governance

22. Corporate governance refers to the structures, systems, and practices for overseeing the direction and management of an organization so it can carry out its mandate and achieve its objectives. We expected that the Board of Directors of the Bank would ensure that roles and responsibilities of governance are well defined and respected and that a clear governance framework is in place to protect the interests of the Bank and its shareholder (the Government of Canada). We also expected that the Board of Directors would use appropriate and timely information to provide strategic direction and governance decisions allowing the Bank to achieve its objectives and expected results.

23. There are 15 directors on the Board, two of them from the public service. The Board has five committees: the Credit/Investment, Governance, Human Resources, and Audit committees, and the Pension Fund Committee and Trustees of the Pension Fund. Like boards of other federal Crown corporations, Board members are appointed by the Governor in Council on the recommendation of the responsible Minister.

The Bank has the core elements of a good governance framework

24. Since our last special examination in 1999, the Bank has invested significant effort in developing and modernizing its governance structure, systems, and practices. Overall, we found in place the core elements of a good governance framework.

25. In 2000, the Board engaged an external organization to survey the Bank's directors and senior managers about its governance practices and to recommend related enhancements. A follow-up in late 2002 noted improvement but concluded that more needed to be done to improve the Board's renewal, strategic planning and performance measurement, the functioning of its committees, and conduct and trust.

26. In this special examination, we found that the roles and responsibilities of the CEO, the Chair, and Board members are generally well defined. Terms of reference have been established for the Board's various committees. Although they have been revised over time, some have not been updated since 1998. The Board is currently updating the Audit Committee's terms of reference. Given recent changes in corporate governance practices in both the public and the private sectors, it is important that the Board ensure that the terms of reference of all committees reflect best practices.

27. The Board has developed a profile of a board with the mix of skills, expertise, experience, and geographical representation to meet the Bank's needs. It has identified the gaps in its composition and communicated them to the Minister for consideration in filling Board vacancies. At the end of our examination, to reflect recent government requirements, the Board was updating its profile and putting in place a structure to identify potential candidates for upcoming vacancies.

28. The Bank provides new directors with orientation and information to ensure that they can govern the organization effectively. We encourage the Bank to expand its orientation and training of directors to cover the public sector environment and its impact on Bank affairs, and best governance practices. Board members could also take advantage of the orientation and training program now offered to Crown corporation directors by the Privy Council Office.

29. The Board is responsible for approving the Bank's strategic direction and takes clear steps to influence it. Each year, directors attends an annual planning retreat with senior management, an open discussion of the Bank's strategic issues, risks, and opportunities. Throughout the year, the Board monitors the progress of the corporation's strategic plans and reviews performance against objectives. As we note later in this report, the Board played an active role in overseeing the development of an integrated risk management framework.

30. The Board assessed its own performance in 2002; directors were generally satisfied with the functioning of the Board and its committees. We encourage the Board to perform such assessments regularly and the Chair to assess the performance of individual Board members. We saw evidence that the Audit Committee carries out its legislated responsibilities. We noted, however, that internal audit reports functionally to the Audit Committee and administratively to the Senior Vice-President Corporate Affairs and Chief Planning Officer; in our view, reporting administratively to the CEO would enhance its independence. We have been informed by Management that this was implemented in June 2004.

The role of public sector directors needs to be clarified

31. We noted a lack of clarity among Board members about the role of public servants on the Board, namely, occasions when other directors deferred to them because they were considered to speak for the government. While the public service members may have the knowledge and expertise to help other Board members appreciate the government's position on certain issues, their function is not to convey direction from the Minister but rather, like other directors, to carry out the statutory obligations set out in the *Financial Administration Act:* to exercise independent judgment in ways that best fulfil their responsibility to the Corporation. In our view, it is important that the understanding of directors of the role of its public service members be clarified.

The selection process for a new CEO is under way

32. The shareholder is responsible for appointing and replacing the CEO and setting his or her remuneration. We noted that the Board annually reviews the performance of the CEO and provides its assessment to the Minister and the Privy Council Office.

33. In March 2004, the Bank's CEO was dismissed. At the end of our examination, the Board was forming a nominating committee and initiating the process to hire a recruitment firm to identify potential candidates for his replacement.

Quality of information to the Board needs to be enhanced

34. Overall, the Board receives the information it needs to evaluate how management is discharging its responsibilities and how the Bank is performing. Board members believe that a significant amount of information they receive for their meetings is useful. However, we noted that they did not receive information on some important issues early enough to carry out informed discussions.

35. We also noted that the minutes of the Board and its committees did not always provide enough detail on the nature of discussions, options considered, or analyses provided to support important decisions. Since February 2004, minutes are more detailed.

36. We encourage the Board and management to continue working together to identify and define the level, quality, and frequency of information that directors should receive and ensure that they receive timely information related to significant risk areas identified in the Bank's integrated risk management framework.

Values and ethics practices should be reaffirmed

37. Recent events in both the private and the public sectors highlight the need for a sound framework of values and ethics. Regulatory bodies and government central agencies are defining related policies, processes, and practices that organizations are to adopt.

38. The Bank has a code of conduct for employees (1999) and guidelines on conduct for directors (2001). In our view, it would benefit from reviewing them to ensure that they are consistent with the spirit and provisions of the new *Values and Ethics Code for the Public Service* issued in September 2003. We have been informed by management that these documents are presently being revised and that proposed changes will be presented to the Board in August 2004.

39. The Total Care Program for dealing with unsatisfied customers is administered by the Bank's Ombudsman, who reports directly to the CEO. We noted that while the process for handling complaints is

set out clearly, the Bank would benefit from clarifying the Ombudsman's responsibilities and reporting accountability. In our view, the process would be strengthened if the Ombudsman's reports were presented directly to the Board and included a summary of recommendations and their status, along with management's response.

40. Some elements of the employee code of conduct address the handling of internal complaints, a process that we noted involves various parties whose roles and responsibilities are not always clear. It is important that the Bank clarify in particular the roles and responsibilities of internal audit and the Ombudsman in the process for handling complaints. This policy should clarify the process for handling complaints of wrong-doings against senior managers or directors. During the special examination, the Bank began to develop a policy on « whistle blowing». We have been informed by Management that the policy was approved by the Board in May 2004.

Strategic and operational planning

41. Strategic planning guides what an organization is, what it does, and why it does it, all with a focus on the future. It includes assessing and adjusting the organization's direction in response to a changing environment, an area where a board of directors plays an important role. The corporate plan ultimately guides the setting of corporate objectives and the allocation of resources.

42. We reviewed the Bank's strategic planning to assess whether their direction and objectives are attainable; take government priorities into account; and are based on adequate analyses of the Bank's operating environment, market, and risks and their financial and operational implications. We also assessed whether its strategic direction and plans were communicated clearly to employees.

Strategic and operational planning systems and practices are adequate

43. Overall, we found that the Bank's strategic and operational planning systems and practices are adequate. The Board of Directors works with senior management to set out the Bank's strategic direction. The direction and plans take account of the government's priorities and are based on appropriate analyses of the Canadian economy, developments in the Canadian small and medium-sized enterprises sector, trends in financing and in private equity, and financial and operating constraints. Strategic direction and plans are clearly communicated throughout the Bank.

44. The planning process has allowed the Bank to manage the important changes its business and operations have undergone over the past years. Our 1999 special examination found that the Bank needed to collect information on its external economic environment from various reliable sources, analyze that information, and distribute the conclusions and results throughout the organization to ensure that business decisions were based on current conditions. This time we found that input for planning comes from a number of reliable sources, both internal and external, such as customer and employee surveys and economic profiles. Planning documents are developed to be shared with as many people as possible, which fosters longer-term strategic thinking among senior management and reinforces the importance of managing and developing client relationships and adding value for the client.

45. In its 2004-2008 Corporate Plan Summary, the Bank sets performance targets for its return on equity, its venture capital internal rate of return, and Consulting Group revenue. The Summary also includes measurable targets relating to the growth of its loan portfolio, customer satisfaction, employee commitment and efficiency ratio. We noted, however, that the Bank has not set specific objectives regarding the medium- and long-term impact of its activities on target groups and stakeholders.

46. The Bank also has a mandate to increase its emphasis on the financial and management services needed by Aboriginal, women, and youth entrepreneurs, and has taken initiatives to do so. However, it has not established objectives specifically for serving these markets; this hinders the ability of the Bank to measure its performance and report on the results it has achieved. We encourage the Bank to set quantitative or qualitative objectives for these markets, develop performance indicators, regularly monitor actual performance, and report on the results achieved.

Performance measurement and reporting

47. Clear measurement and reporting of performance toward public policy objectives is essential to sound management and to meeting public sector expectations for accountability and transparency. We expected that the Bank would have in place a performance measurement process that would provide an overview of its activities and their results and allow it to report its performance internally and externally. We also expected to find a range of performance indicators that would allow the Bank to measure the results of its activities

48. We found that the Bank has a good overview of its operations, and it measures its operational and financial performance against objectives and targets established at both the corporate and the branch levels. Its regular tracking of performance against priority objectives forms the basis for internal accountability agreements. It has developed performance indicators to measure the results of its loans, venture capital investments, and consulting activities and updates them regularly. In addition, activity reports are provided regularly to senior management and the Board of Directors.

Measurement and reporting of contributions to public policy objectives needs to be enhanced.

49. One of the Bank's key corporate objectives is to "create a unique and valued relationship with Canadian entrepreneurs to support the creation of their businesses and accompany their growth." To measure the overall effectiveness of its business solutions in achieving this objective, the Bank focuses on performance indicators such as the level of client satisfaction, the number and value of loans authorized, and the number and value of venture capital investments. Although these indicators convey some sense of the Bank's achievements in the short-term, they do not clearly identify the longer term impact of its activities on target groups and stakeholders.

50. Moving forward, the Bank needs to go beyond its current performance reporting model in order to better report on the extent to which it is fulfilling its public policy mandate. Because of the length of time it takes before the impacts of activities can be seen on the achievement of long-term public policy, good practice in results reporting involves assessing results at different points in time. To track progress toward objectives, the Bank would benefit from defining the results expected from its strategies and business solutions in terms of medium- and long-term impact on business creation and growth of its clients. In our view, such indicators would improve management accountability and enhance stakeholders' ability to meaningfully assess the Bank's performance.

51. We also noted that the Bank has created a Corporate segment team to manage loans of $5 million and above. Generally, private sector financing alternatives become increasingly available as the size of loans increases. Continuing positive working relationships with private sector lenders is strategically important for the Bank. Accordingly, the Bank should consider adopting specific strategies to manage this relationship risk based on predetermined criteria.

52. In our 1999 special examination we noted that the Bank's annual report compared favorably with those of other Crown corporations but could be improved as an accountability document. Our review of

the 2002-03 annual report found more information on objectives, strategies, performance indicators, and results achieved. The report summarizes the Bank's performance and provides links to the Corporate Plan but, for certain initiatives and activities, no analysis is provided of performance against established objectives or targets. We encourage the Bank to continue improving its annual report.

Integrated risk management

Integrated risk management shows significant progress

53. Our previous special examination report indicated that the Bank needed to integrate its management of business risks to ensure that key risks were considered objectively and globally. We encouraged the Bank to introduce best practices in integrated risk management so it could, among other things, properly support the Board of Directors in the effective governance and oversight of its operations.

54. Since then, the Bank has made significant progress in developing an integrated risk management (IRM) approach across the organization. This was accomplished through the strong commitment of both the Board of Directors and senior management to adopt integrated risk management. Priorities were established to develop integrated systems and training programs in the areas most critical to the Bank's lending business: credit lending risk and credit concentration risk.

55. A task force was established to develop a risk management framework and identify the most significant risks facing the Bank. The framework is aimed at describing the Bank's risk environment and providing a common basis for discussing risks across the organization. It is intended to provide a foundation for a common exchange of knowledge among employees who are analyzing risks and developing plans to manage them.

56. The Bank identified various types of risk and prioritized them in a "top ten list" on the basis of probability of occurrence, potential impact in terms of loss over the course of a year, and current management capabilities to manage them. Management and the Board of Directors now review these risks annually. The table below summarizes the top ten risks.

Risk categories	**Specific risks**
Credit risks	• Credit lending • Credit concentration
Market risks	• Venture capital investment and portfolio concentration • Treasury risk; funding, matching assets and hedging
Operational risks	• Systems • People and skills • Match incentives with objectives • Reporting • Business strategies & solutions • Reputation

57. In addition, the Bank created a Business Strategy Council of members of senior management, with a mandate to assess strategic and operational risks from a multi-disciplinary perspective. The Council focuses on risks that could impact the Bank's performance in such areas as new product development, major systems development, and organizational change.

58. Based on our examination work, we concluded that the Bank now has in place an integrated risk management framework that allows it to identify, assess, and manage the important risks it faces. We also noted some areas where improvements can be made.

The Bank's approach to integrated risk management needs to mature

59. Integrated risk management to date has focused primarily on the areas most critical to the Bank's core business: the management of the credit and market risks. The Bank now needs to further develop its approach to integrated risk management and put more emphasis on operational risks.

60. In an effort to advance its understanding of operational risks, the Bank recently analyzed the factors that contribute to loan downgrades and in doing so identified the most frequent operational errors in the loan process. It intends to pursue a plan over the next three years to clearly understand and segregate operational risks from credit risks throughout the loan process. The ability to identify and quantify operational risks is getting a lot of attention in the banking industry as a whole. It will be important for the Bank to monitor future developments across the industry in order to refine its operational risk analysis and supporting procedures.

61. The management of risks to the Bank's reputation also deserves particular attention. The Bank has been the subject of considerable media coverage and requests under the *Access to Information Act* for information on certain reported events. Our interviews with senior management and members of the Board revealed concerns about the impact of these events on the Bank's reputation. In our view, it would be important for the Bank to pay particular attention to the management of risks to its reputation.

Risk management needs to be linked more closely to the strategic and operational planning processes

62. We noted that the risk assessment process is not yet tightly integrated with the Bank's strategic and operational planning processes. As part of annual strategic planning, business line and regional managers need to identify and assess the key risks they face and develop plans to mitigate threats and act on opportunities that could impact on the Bank's business objectives.

63. We also noted that the Bank has a formal framework for planning, testing, and training to support business continuity. However, the branch plans have not been updated for about two and a half years. Recently, the Bank revised its template for business continuity planning in the branches, which are currently reviewing it. Management informed us that branch plans will be updated by the end of May 2004.

64. It is also important that the Business Strategy Council regularly review the areas where exposure to risk is highest. The Executive Vice-President, Integrated Risk and Resource Management, provides a quarterly update to the Board of Directors on the Bank's risk profile and its impact on the strategic and business plans. We noted, however, that these updates do not expand on operational risks. The current integrated-risk-management plan could also be updated to assign responsibilities and set targets for implementing these improvements and further developing the integrated management of risks.

Marketing

The Bank has significantly expanded its marketing capabilities

65. An important role of the marketing department is to provide relevant market information so the Bank can refine its business solutions to continue meeting the financing needs of small and medium-sized enterprises.

66. We found that the marketing function has systems and practices that support the Bank's strategic plans and its objectives of portfolio growth and profitability. The marketing department provides reliable and timely information on the financing needs of small and medium-sized enterprises. Our work and our interviews at the branch level showed that the marketing function provides good support to the sales activities of the branches. Marketing strategies and new product development are based on a good understanding of the marketplace and are implemented effectively.

67. We also noted that the results of client satisfaction surveys are translated into practical recommendations to help field staff in their sales efforts. However, in our view, the Bank would benefit from collecting more information when it rejects a loan, when its offers are declined by entrepreneurs it contacts, and when the business relationship with the client is interrupted. Such information would be helpful in assessing the extent to which the Bank meets market needs and in refining its business solutions. Management informed us that the Customer Relation Enhancement Management (CREM) system, currently in development, will provide the technical capabilities to collect such information centrally.

68. Marketing staff are in frequent contact with operational staff in the field to provide sales support and help them understand the key changes in local markets. Information is often received from the field verbally and is not necessarily recorded in a consistent way by the marketing department. In our view, it would be in the Bank's interest to ensure that the marketing function regularly documents valuable information received from the field to help preserve corporate memory and communicate market information uniformly throughout the organization.

69. Our 1999 special examination report encouraged the Bank to prepare a marketing plan that could guide the development and marketing of its business solutions. We note that the marketing department has since developed some plans but they are not yet complete. For instance, they do not include such information as perceived strategic initiatives of the major lenders in Canada, the links between the national and the regional strategies, and links to the advertising and promotion strategies and budgets. We encourage the Bank to complete its marketing plans.

Lending activities

70. Lending activities are at the core of the Bank's business and represent the most profitable part of its operations. As shown in Appendix B, the Bank's loan portfolio has increased by almost 50 percent from 31 March 1999 to 31 March 2003. Income from loans operations more than doubled during that period.

71. In our 1999 special examination we noted that the Bank needed to enhance its portfolio management practices and improve the assessment of concentration risk. Since then, it has reinforced its practices in both areas. We concluded that systems and practices for lending activities contribute to the portfolio growth as well as to the Bank's public policy and profitability objectives. We also found that

appropriate policies, procedures, and controls are in place to ensure that lending activities are managed within the Bank's risk tolerance threshold.

The Bank reinforced its lending risk management analysis and tools

72. To ensure a balance between its public policy objectives and its targets for risk and return, the Bank significantly reinforced the analytic and valuation tools it uses to manage lending risk. It implemented a new tool (Analytix) for managing and monitoring loan portfolio risks associated with a given branch, industry sector, or business solution.

73. In our view, this improvement in risk management will help the Bank achieve one of the most important objectives of its business plan – increasing the risk taken with clients demonstrating a strong potential for growth and a high likelihood of generating repeat business. The risk management tools are well understood and used across the Bank. However, we noted that the underlying principles governing the management of concentration risk are not yet documented in a policy. Formalizing these principles would support the current approach by defining stress-tests and watch-list thresholds by industry or subgroup for monitoring by management, while balancing with the requirements of a public policy mandate.

Effective controls are in place for pricing and lending decisions

74. The Bank introduced the FAIR pricing tool with the objective of pricing loans at an equitable level for both the Bank and its clients. This tool guides managers in establishing fair loan interest rates, commensurate with the risk that a given client represents, using an historical client database. The tool is consistent with industry best practices in credit risk management and pricing. It enables the Bank to carry out its role as a complementary lender by equipping it properly to price loans to risks. Managers also have the flexibility to change the interest rate spreads to reflect the Bank's public policy mandate or its market strategy. This pricing process is expected to improve further as the Bank completes its project to increase the number of risk-rating categories.

75. Based on our interviews with representatives of chartered banks, we understand that in general the Bank does not compete with them. Its senior management continually reinforces awareness in the field about the sensitivity of profits to pricing deviations. The level of portfolio risk the Bank is prepared to tolerate is presented annually to the Board of Directors and then reflected in the corporate business plan. Reports are provided regularly to the Board on changes in profitability and portfolio risk compared against plans.

76. Loans are subject to environmental conditions being met. An environmental risk assessment is performed, when applicable, before a loan is authorized. We noted that the environmental risk policy is applied rigorously and is generally more conservative that those applied by commercial banks. It includes namely mandatory Phase I or Phase II environmental reports performed by certified environmental expert advisors. We noted, however, that the current environmental risk circular was issued in 1996. Although there have been a number of ad-hoc amendments since its origin, the circular needs to be entirely reviewed to reflect the current context of environmental legislation, expectations and issues to be addressed. We understand that this update process is underway, with the support of a certified expert advisor firm, and that an updated document will be issued by summer 2004.

77. The Bank proceeded with an in-depth review of its lending processes and structure in 2001 in order to achieve three major goals: increase its efficiency, improve customer satisfaction/retention, and improve employee engagement. The new work organization was implemented in 2002 through the

creation of three different groups of employees targeting different needs: one group is specialized in customer relationships and getting new customers (business developers); another group is looking after portfolio administration and customer retention or repeat business (portfolio developers); and finally a third group is dedicated to underwriting the loans sourced by the other teams. With this concept, the Bank also decentralized its Credit function where the percentage of loans authorized by the local network sits at more than 95%, bringing the decision closer to the customer and to the market which is an important aspect of the Bank's mandate by being more present in all regions across Canada.

Venture capital investment activities

78. To support its public policy objectives, the government asked the Bank to enter the venture capital business and reiterated that intention in the 2000 review of the Bank's mandate.

79. The Bank has developed a strategy that covers the broad investment spectrum of financial needs from pre-seed to expansion. It uses different mechanisms such as technology seed investments, fund investments, direct investments, and subordinate financing to achieve its objectives. The Bank's financial commitment to companies it invests in generally spans four to seven years so the companies can reach a market value threshold that attracts other investors. The investment group portfolio grew from $70 million at 31 March 1998 to $302 million at 31 March 2003, excluding its subordinate financing component.

80. We concluded that systems and practices in place for venture capital investment activities allow the Bank to capture market opportunities and meet the needs of targeted enterprises in accordance with approved plans and its objectives of portfolio growth and profitability. Adequate controls are also in place to ensure that venture capital investment activities are managed within the Bank's risk tolerance threshold.

81. We also noted that the Bank has successfully addressed the issues we raised in our last special examination — its monitoring and reporting of investments, accountability for seed capital funds, and the need for investment authorization thresholds on total commitments (direct and indirect) in a single portfolio company. As a result, it has improved the due diligence and accountability processes for the investment portfolio as a whole.

The Bank is proactively seeking new market opportunities

82. Since our last special examination, the Bank has undertaken major initiatives based on benchmarking exercises to capture new market opportunities, respond to market needs, and pursue its objective of becoming a more important player in the Canadian venture capital and subordinate financing areas. For example, it has moved to a business-line model that provides for group specialization and a technology-based focus; direct seed investments; a new "Fund of Funds" initiative; and a subordinate-financing business unit. The latter is being expanded through the recent acquisition of CDP Accès Capital's portfolio and the creation of a new $300 million joint fund with the Caisse de dépôt et placement du Québec.

Effective controls are in place for investment decisions

83. The Internal Venture Capital Committee (vice-presidents and members of the risk management practice) reviews and approves all lower value investments, divestitures, and amendments and recommend all higher value transactions for approval by a committee of the Board. The Bank also uses a range of monitoring practices such as peer reviews and independent party involvement in complex

venture capital reinvestment cases, and monthly monitoring of new subordinate financing investments for the first 12 months.

84. We also noted that the Bank has updated the user guide to encompass all of the Venture Capital Group's business units; developed a training course for all venture capital personnel; and developed venture capital software.

Investment and divesture policies should be formalized

85. To foster accountability for venture capital decisions and remain within its mandate, the Bank needs to formalize its investment and divestiture practices. It needs to establish the Venture Capital Group's guiding principles in a formal corporate policy, approved by the Board of Directors and covering, for example, venture capital divestiture and the role and responsibilities of the Internal Venture Capital Committee. Further, the underlying principles followed by the Committee in making decisions should be formally documented.

Consulting activities

Significant improvements have been made in consulting services

86. To be able to respond more effectively to the changing needs of Canadian small and medium-sized enterprises, the Bank carried out a major review of its consulting services between 1996 and 1998. It found that its services were becoming redundant as new players entering the market provided training, counseling, and business-planning advice. The review also noted that by targeting clients in its lending portfolio, its consulting activities could meet the objective of cost recovery over the long term.

87. During our 1999 special examination, the Bank was working to finish re-engineering its consulting activities. We commented on the action plans it had prepared, noting that roles and responsibilities for actions remaining were not clear and there were no target dates for their completion.

88. The Bank has since made significant improvements in the delivery of its consulting services. For example, it has hired additional directors who have consulting experience with small and medium-sized enterprises and project management, and reviewed the Consulting Group's solutions for better addressing the consulting needs of small and medium-sized enterprises. It also streamlined its network of consultants to support its specialization sectors of growth, quality, exportation, and e-commerce. Finally, the Bank reviewed the Consulting Group's strategic role and adopted a strategy in 2002 that resulted in integrating consulting activities with financial services in a single point of customer access.

89. Over the past year, the Bank has continued to implement this strategy. The broad objectives are to support small businesses as they grow into medium-sized enterprises and helping Canadian entrepreneurs to improve their management and leadership capacity. In our visits in the regional offices, we noted that the strategy's implementation was going well.

90. The Bank's principal sources of information on the consulting market and clients' needs are its staff in the field and its surveys of client satisfaction; we noted that the information collected in the field is communicated verbally and informally to the Bank's Head Office. However, we found limited documentation showing how the information has been analyzed. We also noted that information from the client satisfaction surveys is analyzed only informally by the Consulting Group and there is no documentation to support the analysis, the resulting action plans, and their timeframes. In our view, to

make an effective use of the information collected and preserve its corporate memory, the Bank needs to better document its analysis of the consulting market and client needs.

An evaluation framework needs to be developed

91. After several years of transforming its consulting services, the Bank needs to develop an integrated framework for evaluating the implementation of its strategy. Such a framework could bring together the various short- and long-term objectives and performance indicators that have been established to assess the overall effectiveness of the strategy, and the requirement to report on its performance both internally and externally.

92. Based on our examination work, we concluded that the Bank has the systems and practices in place to ensure that its consulting activities are focused on providing high-quality service, meeting the needs of its clients, and helping with the start-up and growth of small and medium-sized enterprises.

Human resources management

93. The Bank recognizes that its employees are the foundation of the organization: its human resources strategy is based on the principle that employees who are engaged will provide high-quality service to clients.

94. We expected that the Bank would have systems and practices in place to ensure that its employees have the core competencies and skills to meet its goals and objectives. We expected its compensation plan to reflect its business objectives and strategies, including a balance between its public policy mandate and its commercial operations.

The Bank's training and succession planning practices work well

95. Following the last special examination, the Bank sought employees' input through an Employee Engagement Survey, focus groups, and meetings with senior managers; it developed an action plan and undertook to address the issues employees had identified. The Human Resources department clarified that its mission and role are to facilitate and support the Bank's business units. It also ensures that all departments identify their required competencies and their development needs and adopt the tools that will help them achieve their goals.

96. Recognizing that it needs to develop and retain people with the right competencies for its operations, the Bank has adopted the necessary policies, procedures, and tools. For example, in its career management process, employees are expected to take an active role in their career progression and professional development. The Bank Leadership Institute and the President's Leadership Forum were introduced to ensure that the Bank has the required leadership talent and capacity to meet business challenges. These initiatives also provide valuable information for succession planning while fostering a culture of learning and growth. Although these appear to be the right training and development tools and methods for the Bank, their effectiveness remains to be demonstrated. We encourage the Bank to continue assessing these initiatives to make sure they meet its needs.

97. The Bank has reviewed its succession planning practices; it has identified key positions and approved a succession plan, which is reviewed periodically by the Board's Human Resources Committee. We note that since the last special examination, the rate of staff turnover has improved and the average delay in filling vacant positions has been reduced.

Some elements of the compensation programs need to be further analyzed

98. The Bank has developed a global compensation package aimed at recruiting, motivating, and retaining the human resources it needs. Staff are compensated with a base salary according to employee level as well as a variable pay plan based on the attainment of both corporate and individual objectives. In addition, there are long-term incentive plans for venture capital employees, subordinate financing employees and senior management. Salaries are benchmarked annually against those of similar organizations to ensure that they reflect current compensation approaches and levels.

99. We found that the complex long-term incentive plans require numerous calculations and have been modified often since 2000. While we recognize that changes may be needed over time to reflect changing circumstances, we are concerned about their frequency. In our view, the Bank needs to develop scenarios that would clearly demonstrate how a variety of operating results would affect its remuneration package and provide that information to the Board of Directors when seeking its approval to modify incentive plans. This would help ensure that the remuneration package responds to current needs and circumstances and is competitive with others in the financial sector while taking into consideration the public sector remuneration values.

Treasury activities and risk management

100. The Bank manages its cash and liquidity position and finances its activities by projecting future cash needs, managing its investment portfolio, borrowing from the capital and money markets to support lending activities, and managing risks in its treasury operations.

101. As the Bank depends largely on borrowings to fund its activities, it tries to reduce its cost of borrowing by issuing a variety of structured debt instruments in international markets, which exposes it to foreign currency and equity market risks. It manages those risks by using derivatives to synthetically alter the structure of its debt products issued, thereby increasing its exposure to counterparty credit risk. Monitoring that exposure is an ongoing activity of the Bank. Its borrowing practices and use of derivative financial instruments in the capital and money markets allow the Bank to reduce its cost of funds and ensure that it is not exposed unduly to risks in capital markets, as required by the constituting Act.

Treasury management systems and practices support sound investment and borrowing decisions

102. The Treasury department's liquidity management, investing, and borrowing activities expose the Bank to various financial risks including market risk, credit risk, foreign currency risk, and interest rate risk. To manage or limit those exposures the Bank has established policies and procedures that are consistent with guidelines established for Crown corporations by the Minister of Finance. The Bank's Asset and Liability Committee members of senior management oversee risk management activities and compliance with policies. The Treasury Middle Office, created to monitor risk exposures and compliance with risk management policies, reports all cases of non-compliance to the Committee.

103. The Bank's management of treasury risk and its compliance with the Minister of Finance's guidelines for Crown corporations hinged on the successful implementation of ASKARI, its risk management information system. Now fully operational, the system is used to manage the Bank's exposure to interest rate risk, market risk (using value-at-risk methodology) as well as counterparty credit risk on most derivative financial instruments. The Bank's Credit Support Agreements with most of its derivative counterparties require that they provide it with collateral when credit exposures exceed a set limit.

104. The more complex derivative instruments are still valued manually. It is important that the Bank continue to evaluate more automated means of performing these calculations with minimal manual intervention and on a more frequent basis.

105. The Bank monitors its capital base and measures capital adequacy in accordance with Treasury Board guidelines. The measurement of capital adequacy risk covers accounting capital; regulatory capital (by type of asset: secured loans, unsecured loans, and venture capital investments); and economic capital, based on risk exposures and probability of loss. Adequacy of accounting capital is measured during the corporate planning process, and funding requirements are communicated to the government in the Corporate Plan. Economic capital is calculated and reported to the Board on a quarterly basis.

106. We have concluded that the Bank's treasury management activities and strategies are consistent with corporate objectives, legal provisions, its risk tolerance threshold, and are undertaken in a cost effective manner. We also noted that the Bank has addressed our 1999 special examination findings on cash management and counterparty risk.

Information technology management

107. Given the importance of information technology (IT) to the Bank's activities, we expected that the planning, development, implementation, and management of IT systems would ensure business continuity, satisfy information needs at an acceptable cost and on a timely basis, and support the Bank's growth objectives.

The information technology environment has improved significantly

108. In our 1999 special examination report, we noted the need for improvements in the organizational structure of the IT function and in its change management, business continuity planning, systems development, and project management.

109. Since then, the Bank has made significant progress with systems and practices designed to improve its information technology environment. It hired three new systems and technology directors and increased its full-time IT complement. Although the Bank still uses many IT contractors, generally it is when development projects need their specific expertise. This approach provides for a quick start to projects, particularly with new technologies, and the transfer of skills to permanent employees.

110. The Bank has established an IT Investment Committee of senior executives responsible for reviewing and approving all major IT initiatives. It has developed several major business applications, including the Customer Relation Enhancement Management system (CREM), Business Intelligence, and Corporate Portals, and it plans to deploy them over the next three years. The Bank has taken steps to reduce risks and achieve positive results by embracing a new development methodology, setting up a Program Management Office, establishing rules for project governance, defining integrated technology architecture, and dedicating end-user resources to major development projects. Finally, in stabilizing its day-to-day operations and using more robust processes, the IT Group has reduced the number of problems and significant outages and has improved security. The results of a user satisfaction survey reflect a more robust and stable operation and better support to internal customers.

The Bank needs to improve its planning and project prioritization processes

111. Given the size of the Bank and its finite resources, the number of concurrent projects now underway could detract from a focus on large critical projects such as CREM -- one of the most critical projects for the Bank due to its size, complexity, and in-house development. Although management has demonstrated a firm commitment to the project's success and has taken many steps to manage risks and achieve positive results, in our view it needs to improve planning and project prioritization.

112. We suggest that going forward, the Bank review its planning and prioritization processes with a view to limiting the number of concurrent projects in order to deliver the strategic initiatives sooner and get an earlier return on its investments.

113. We also noted the Bank's practice of developing business cases for information systems initiatives, including cost-benefit analyses, which the Investment Committee uses in prioritizing and approving projects. However, the cost-benefit analyses do not include maintenance and support costs over the projected useful life of a system. Including those costs in its analyses would make the total costs of a project clear before its approval. Our review of management's internal reports on the status of CREM indicate that, although the overall cost is aligned with the total budget, the development effort and cost are higher than originally planned. We encourage the Bank to continue monitoring development efforts and costs to ensure that the gap between planned and actual amounts does not grow, and that the overall project remains within budget.

114. We also noted some inconsistencies among project status reports in the elements included as development costs and development efforts. Standardized reporting on projects would improve project management.

115. Currently a Security Officer reports to the Director, IT Planning and Administration, who in turn reports to the Vice President, Systems and Technology. Monitoring and reporting of IT security incidents should be the responsibility of someone who is independent of the Systems and Technology department. The Bank would benefit from modifying this reporting relationship to provide for a better segregation of duties.

CONCLUSION

116. As stated in our special examination opinion, we concluded that during the period under examination, the systems and practices of the Bank 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.

117. Throughout this report we also identified various opportunities to enhance the quality of these systems and practices. In our view, the Bank should pay particular attention to:

- enhancing the completeness and timeliness of information provided to the Board of Directors on key risk areas, all material issues and staff compensation programs;
- reaffirming its values and ethics practices;
- enhancing the measurement and reporting of its long-term contribution to public policy objectives;

- maturing its integrated risk management approach, especially for operational risks; and
- formalizing its Venture Capital investment and divestiture practices.

MANAGEMENT'S RESPONSE

BDC has just completed its 60th year and continues to respond to the needs of entrepreneurs across Canada. The reconfirmation of its mandate by Parliament (through public hearings before the Standing Committee on Industry Science and Technology of the House of Commons) in April 2002 reiterated BDC's orientation for the future which has been embraced by clients, the financial community and employees alike.

Strongly committed to client satisfaction and employee engagement, BDC is building on a solid foundation of its core values: ethical leadership, accountability and teamwork to fulfill its mission and achieve its vision of helping Canadian entrepreneurs prosper and grow.

We acknowledge this report and, as with previous reports, intend to diligently integrate its observations within our on-going strategic business plans as follows:

Enhancing the completeness and timeliness of information provided to the Board of Directors on key risk areas, all material issues and staff compensation programs

BDC is committed to displaying "best practices" in all areas of governance and management. Communications between Management and the Board must be complete and transparent. Management has already taken measures to ensure that, going forward, information provided to the Board on all material issues is complete and timely. Specifically, as part of BDC's ongoing integrated risk management, the regular credit risk report to the Board will be broadened to include other important risks and management's mitigation measures. The last fiscal year has seen a broader review and analysis of BDC's compensation practices presented and discussed with the Human Resources Committee of the Board.

Reaffirming its values and ethics practices

BDC fosters strong ethical leadership from each and every one of its employees through an established foundation of values, clear policies, (i.e. Code of Conduct and Eligibility) performance management, management/employee forums and discussions at all levels, and day-to-day activities (a well established due diligence process, supplier management process, and HR management practices). With dedicated focus on its clients as set out in its mission, BDC values accountability, teamwork and the fulfillment of its employees. As with any organization, BDC must ensure compliance and will continue to strive to improve its policies, processes and information systems to ensure clarity of the behaviours expected from all employees. BDC's Code of Conduct is currently under review and a refreshed version is expected to be presented to the Board later this year. In addition, a whistleblowing policy has already been approved by the Board.

Enhancing the measurement and reporting of its long-term contribution to public policy objectives

First established through the new BDC Act of 1995 and then reiterated by Parliament in 2002, BDC's complementary role focuses on four market gaps: risk, size, flexibility and knowledge. BDC fulfills its mission while balancing the risk it takes with the need to earn a rate of return equal to the government's long-term cost of funds. The government has requested that BDC should plan to earn a surplus. Accordingly, BDC is required to maintain a delicate balance between its public policy role and financial responsibility.

BDC's current seven performance indicators were developed to provide a solid basis for evaluating progress for both commercial and public policy purposes. BDC develops strategies based on ongoing market analyses and client feedback to ensure that its services respond to the specific needs of Canadian entrepreneurs. These provide additional information that is analysed and reported on internally by our Business Strategy Council.

Positive feedback from its 23,000 plus current clients and other stakeholders have been key in helping BDC achieve and balance its public policy and commercial mandates. Throughout this work, the difficulty of identifying satisfying public policy measures has been recognized. BDC undertakes to continue to further its thinking within a longer-term perspective of the public policy contribution it makes, through the development of a public policy scorecard which could consist of additional quantitative and/or qualitative measures of outcomes.

Maturing its integrated risk management approach, especially for operational risks

Integrated risk management has been embraced by BDC from a business operations, planning and management standpoint and has necessarily been highly focussed on developing additional toolsets for its key risks which are primarily credit risk related. The risk integration plan at BDC includes risk projects aimed at enhancing risk management awareness and practices in all areas. As a financial institution BDC recognizes the operational risks inherent in all aspects of its activities, is drawing from the current discussion around the BASEL requirements and will be working over the next few years to integrate operational risk elements within its risk integration projects.

Formalizing its Venture Capital investment and divestiture practices

A project is underway to complete this by the end of the year. Some aspects of this opportunity are not in evidence elsewhere in the VC industry and BDC will be required to pioneer best practices.

In conclusion, we would like to thank the Auditor General of Canada and KPMG and their teams for their helpful contribution made in this report.

Appendix A – Systems and Practices Examined and Examination Criteria

Governance

The Board of Directors ensures that roles and responsibilities related to governance activities are well defined and applied and that a well articulated governance framework is in place and protects the interests of the Bank and of its shareholder.

Strategic and operational planning

The Bank clearly communicates its orientation and plans. The orientation and plans are attainable, take into account government priorities and are based on adequate analyses of the environment, of the market, of the risks and of the financial and operational implications.

The Board of Directors, using appropriate and timely information, provides the required strategic direction and makes governing decisions allowing the Bank to meet its objectives and expected results.

Performance measurement and reporting

Operational performance is measured using established objectives and targets at the corporate and branch levels. Performance is subject to regular reporting in order to facilitate internal as well as external decision-making and accountability.

Integrated risk management

The integrated risk management framework allows the identification, assessment (acceptable tolerance level) and management of all of the important risks that the Bank faces. The action plan is effectively communicated and implemented.

Marketing

The marketing systems and practices support strategic planning as well as the realization of the Bank's portfolio growth and profitability objectives. Marketing strategies and new product development are based on a good understanding of the marketplace, meet customer needs and are implemented effectively.

Lending activities

Lending activities contribute to the portfolio growth as well as to the Bank's public policy mandate and profitability objectives.

Venture capital investment activities

Venture capital investment activities allow the Bank to capture market opportunities in order to meet the needs of targeted enterprises in accordance with the approved plans and in accordance with the portfolio growth and profitability objectives.

Consulting activities

Consulting activities are focused on quality service, meet the needs of the market and help the creation and growth of Canadian small and medium-sized enterprises.

Human resources management

The human resources management systems and practices support corporate objectives and enable the Bank to maintain sufficient and competent personnel through recruiting, training and development, performance evaluation and remuneration.

Information technology management

The planning, development, implementation and management of information technology systems ensure business continuity and satisfy informational needs at an acceptable cost/benefit and on a timely basis, as well as support the Bank's growth objectives.

Credit risk and loans and venture capital portfolio management

Appropriate policies, procedures and controls are in place to ensure the targeted growth and profitability of the portfolio based on the Bank's risk tolerance threshold.

Treasury activities and risk management

Treasury activities and strategies are in accordance with corporate objectives, legal provisions and the Bank's risk tolerance threshold and are undertaken at the lowest cost.

APPENDIX B – KEY PERFORMANCE MEASURES AND SELECTED FINANCIAL DATA[1]

	2003	2002	2001	2000	1999
Key Performance Measures					
Client satisfaction level	**91 %**	90%	88%	88%	86%
Employee commitment level	**76 %**	75%	63%	Not available	Not available
Loan productivity ratio (expressed as the ratio of operating and administrative expenses over net interest and other income – the lower, the better)	**47.8 %**	48.5%	52.6%	54.7%	57.4%
Outstanding loan portfolio (in $ billion)	**$6.7**	$6.1	$5.4	$4.9	$4.5
Consulting Group revenue (in $ million)	**$18.2**	$18.2	$17.7	$19.4	$17.8
10 year internal rate of return on total venture capital investments	**16.3%**	25.6%	27.9%	24.9%	13.6%
Return on Common Equity (RCO)	**2.7 %**	5.7%	12.6%	18.7%	6.4%

	2003	2002	2001	2000	1999
Key Financial Data (in $ thousands)					
INCOME					
Net interest income – Loans	**338,156**	312,273	302,225	263,358	242,341
Other income – Loans	**30,800**	28,372	Included above	Included above	Included above
Operating and administrative expenses - Loans	**(176,449)**	(165,187)	(158,971)	(144,038)	(139,198)
Provision for credit losses - Loans	**(98,000)**	(95,000)	(106,000)	(94,000)	(61,019)
Income from Loans	**94,507**	80,458	37,254	25,320	42,124
Income (loss) from Venture Capital	**(59,485)**	(20,977)	56,168	80,039	(4,124)
Loss from Consulting Group	**(3,142)**	(5,748)	(5,100)	(4,254)	(5,216)
Net income	**31,880**	53,733	88,322	101,105	32,784
PORTFOLIOS					
Loans – gross amount	**6,715 345**	6.070,699	5,412,408	4,902,922	4,501,193
Loans -- allowance for credit losses	**(426,709)**	(401,786)	(358,154)	(294,804)	(252,448)
Loans – net of allowance for credit losses	**6,286,636**	5,669,513	5,054,254	4,608,118	4,248,745
Venture Capital investments - net of accumulated write-down of investments	**301,945**	271,064	206,360	145,107	110,298

[1] Source : BDC's Annual Reports

APPENDIX C – NEW LOANS AUTHORIZATION STATISTICS[2]

	2003	2002	2001	2000
Average Value of new loans authorized - In dollars	321,199	302,874	300,445	291,341
New loans authorized - Distribution of Numbers by Size				
$ 100,000 or less	46.5%	44.8%	43.2%	41.0%
Over $ 100,000 to $ 250,000	22.8%	24.4%	24.7%	25.4%
Over $ 250,000 to $ 500,000	15.2%	16,0%	17.2%	18.3%
Over $ 500,000 to $ 1,000,000	8.6%	9.1%	9.5%	10.4%
Over $ 1,000,000	6.9%	5.7%	5.4%	4.9%
New loans authorized – Distribution of Numbers by Geographic Area				
Atlantic Provinces	12.4%	10.4%	11.3%	12.7%
Quebec	33.4%	34.9%	35.7%	37.4%
Ontario	31.9%	32.9%	30.9%	27.2%
Prairies, Northwest Territories and Nunavut	12.5%	11.5%	12.2%	12.5%
British Colombia and Yukon	9.8%	10.3%	9.9%	10.2%
New loans authorized - Distribution of Dollars by Size				
$ 100,000 or less	7.7%	7.9%	7.5%	7.3%
Over $ 100,000 to $ 250,000	12.1%	14.2%	14.3%	15.3%
Over $ 250,000 to $ 500,000	17.3%	19.1%	20.7%	22.4%
Over $ 500,000 to $ 1,000,000	19.2%	21.5%	22.4%	25.7%
Over $ 1,000,000	43.7%	37.3%	35.1%	29.3%
New loans authorized - Distribution of Dollars by Geographic Area				
Atlantic Provinces	10.8%	9.1%	9.3%	10.2%
Quebec	35.8%	36.6%	39.4%	42.7%
Ontario	36.5%	37.1%	33.2%	30.0%
Prairies, Northwest Territories and Nunavut	9.2%	9.9%	10.4%	9.8%
British Colombia and Yukon	7.7%	7.3%	7.7%	7.3%

[2] From BDC internal unaudited data that exclude the Student Business Loans and Global Lines of Credit products that are no longer offered since Fiscal 2003.