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# Federal Economic Development Initiative in Northern Ontario (FEDNOR)

## Audit Report

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Consulting and Audit Canada  
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Canada 

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## Executive Summary

This report represents the results of the detailed examination phase for Industry Canada's internal audit of the Federal Economic Development Initiative in Northern Ontario (FEDNOR) following the results of the preliminary survey, issued in May 1999. This audit was undertaken pursuant to the Industry Canada's approved annual audit plan for 1999/2000. Consistent with the agreed scope and objectives for the internal audit, this report presents the audit results on:

- FEDNOR's management of its contribution programs.
- FEDNOR's progress in implementing its change agenda.

The orientation of our work was forward looking, focusing on current and proposed management practices, as they relate to contribution agreements. Accordingly, we examined contribution agreements, which were initiated during or subsequent to the 1998-1999 fiscal year. Our emphasis was on systems and practices in place as at the time of the audit with a view to ensure that current practices complied with good management practices and policies requirements for grants and contributions.

Our audit of FEDNOR's management of its contribution programs is based on a review of project files. We concluded that:

- Sufficient information on file to assess the merits of a project proposal and reasonable rationale had been provided by FEDNOR officers, when recommending a project for approval.
- Project approvals were duly documented and in accordance with relevant signing authorities.
- Signed letters of offer and amendments were on file. Amendments were appropriately justified.
- All claims reviewed were well supported.
- There is evidence of good financial stewardship being exercised by FEDNOR in the administration of its contribution programs.

Minor exceptions were observed and have been discussed with management for its follow-up.

Based on our review of files, we concluded that the reasons for an environmental assessment, as part of the project approval process, need to be better documented. We also concluded that opportunities exist to improve FEDNOR's administration of claims and its monitoring of projects. Both areas would benefit from better use of risk management techniques. The claims settlement process appears to be burdened by too much paper and poses requirements on recipients, which do not adequately consider the recipient's risk profile. Project monitoring is acknowledged as an area of exposure, especially as it relates to more recent projects. The current reorganization by FEDNOR involves a re-examination of organizational arrangements and operating practices in order to improve client service and the effectiveness of project monitoring.

FEDNOR has made significant progress in its implementation of its change agenda. Specifically:

- It is implementing a revised organizational structure, which will provide FEDNOR with three offices capable of delivering the full complement of FEDNOR's programs.

- Conceptual work has continued in the development of performance measurement and reporting practices, as it relates to outcomes and benefits derived from contribution projects.
- General management practices continue to evolve in a positive manner, including business planning, reporting of achievements and financial management.
- The Communications function is staffed and has aligned its services in support of FEDNOR's management.
- FEDNOR has developed a Memorandum of Understanding (MOU) with the Department's Ontario Regional Office.

There are no specific recommendations regarding FEDNOR's progress as it relates to its reorganization and organizational evolution. We have made a number of suggestions for management's consideration, as FEDNOR moves forward.

## Introduction

This report represents the results of the detailed examination phase for Industry Canada's internal audit of the Federal Economic Development Initiative in Northern Ontario (FEDNOR) following the results of the preliminary survey, issued in May 1999. This audit was undertaken pursuant to the Industry Canada's approved annual audit plan for 1999/2000. In discussion with FEDNOR's management, it was agreed to that the examination phase would provide:

- A detailed analysis of the contribution funding administration requirements and approval process.
- A status report on FEDNOR's change agenda.

## Background

In 1987, the government introduced FEDNOR as a five-year regional adjustment program designed to promote business development, primarily through the provision of direct financial contributions to the private sector. In March 1992, FEDNOR received the first of its program extensions for a five-year term. In October 1995, FEDNOR was given the responsibility for the direct delivery of the Community Futures Program in Ontario with an ongoing A-base budget which currently stands at \$11,833,000.

In March of 1996, the Minister of Industry announced a re-engineered FEDNOR with a renewed three-year, \$60 million mandate developed in consultation with various stakeholders, interest groups, regional organizations and the Northern Ontario caucus. Consistent with new approaches to regional development, FEDNOR moved away from direct subsidies to business, focusing on partnership with not-for-profit entities to spur economic development. The revised FEDNOR has replaced firm-specific financing, delivered under the former Business Incentives Program (BIP), with commercially-based, fully repayable loans backed by loan loss reserves. In addition, FEDNOR adopted a redesigned funding framework with emphasis on community-based delivery and decision-making focusing on the broader strategic issues of business competitiveness, networking and partnerships, and use of the information highway.

In the 1998 Budget Plan, the Minister of Finance announced continuing support for Northern Ontario communities by confirming that the financial commitment provided to FEDNOR will be maintained at \$20 million per year after 1998-99.

FEDNOR's mission is to promote economic growth, diversification, job creation and sustainable, self-reliant communities in Northern Ontario by working with community partners and other organizations to improve small business access to capital, information and markets. FEDNOR's activities include:

- Improving small business access to capital in Northern Ontario by leveraging resources through the establishment of partnerships with financial institutions to provide new tools for higher-risk financing; providing additional investment funds to Community Futures Development Corporations (CFDCs); supporting pre-commercial research and development and marketing; and implementing special initiatives designed to overcome the barriers faced by Aboriginal people, youth, women and Francophones in accessing capital.
- Improving access to information by encouraging the upgrading of telecommunications infrastructure to enable all communities to connect to the information highway; supporting

the efforts of communities to maximize the commercial benefits that connection to the information highway provides; assisting in the implementation of Information Highway Applications Branch (IHAB) programs and initiatives; and improving the informatics capacity of CFDCs and networking them with the Canada-Ontario Business Service Centres (COBSC).

- Improving access to markets by establishing co-operative working relationships with other research organizations to promote technology diffusion and innovation; supporting national and regional export trade initiatives; developing a database of export-ready small and medium sized enterprises in Northern Ontario; and encouraging the development of business networks.
- Enhancing community alliances by fostering a culture of continuous improvement and self-reliance in CFDCs; supporting enhanced integration and coordination of community-based economic development efforts; promoting the federal identity in its community partnerships; supporting community strategies which create employment and economic growth; and ensuring equitable and effective access to programs and services for all clients through community-based delivery mechanisms.

Since its renewal in 1996, FEDNOR has:

- Approved in excess of 350 projects totaling more than \$27,400,000;
- Provided \$2,600,000 of seed loan and investment funds to the Business Development Bank and the Royal Bank of Canada which financed an additional 81 projects leveraging \$10,500,000 in newly available commercial lending capital; and
- Delivered a further \$37,000,000 in direct funding support to assist Ontario's 52 CFDCs with their annual operations.

With offices in Sudbury, Sault Ste. Marie and Thunder Bay, FEDNOR currently employs 54 people including 19 staff who deliver the Ontario Community Futures Program. FEDNOR recently opened a fourth office in Timmins.

## **Scope and Objectives**

### **Scope**

The scope of the audit includes an assessment of the management control activities of planning, organizing, coordinating and monitoring and key administrative, financial, and human resources activities in support of FEDNOR's operations. More specifically, it includes:

- the general direction and coordination of the FEDNOR office, including roles and accountabilities<sup>1</sup>;

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<sup>1</sup> Subsequent to our on-site visit to FEDNOR's offices during the Preliminary Survey Phase, the Director General, FEDNOR's reporting relationship was changed from the Regional Executive Director, Ontario Region to the ADM, Operations.

- organizational arrangements and relationships, including relationships with Ontario ministries, such as Northern Development and Mines, because of the challenges (such as economic disparity, geographic distances and client cultural attributes) of doing business in Northern Ontario;
- management control systems, including those related to finance, planning and control and communications, including the processing of Ministerial correspondence;
- management of human resources, including an assessment of staffing processes;
- finance and administration, including budgetary control and control over expenditures, and procurement practices; and,
- program administration (i.e. administration of grants and contributions).

The orientation of our work was forward looking, focusing on current and proposed management practices, as they relate to contribution agreements. Accordingly, we examined contribution agreements, which were initiated during or subsequent to the 1998-1999 fiscal year.

### **Objectives**

The objectives of the audit are to assess the adequacy of the management control framework (which details policies, systems and processes) for FEDNOR to carry out its mandate and deliver FEDNOR's services and programs; in compliance with relevant Industry Canada and Central Agency policies.

Our emphasis was on systems and practices in place as at the time of the audit with a view to ensure that current practices complied with good management practices and policies requirements for grants and contributions.

### **Audit Approach and Schedule**

#### **Audit Approach**

The internal audit was conducted in two phases.

#### ***PHASE I - Preliminary Survey Phase***

The Preliminary Survey phase involved site visits to Sault Ste. Marie and Sudbury and interviews with selected managers at Industry Canada Headquarters and in the Ontario Regional Office. Interviews were conducted with and information was gathered from key managers at the FEDNOR offices, Industry Canada Headquarters, and in the Ontario Regional Office. Interviews included the Associate ADM, the Regional Executive Director, Ontario Region, members of the Ontario Region Management Team, the Director General, FEDNOR, all of FEDNOR's directors and selected managers.

Information and relevant documentation gathered was reviewed and analyzed, providing our basis for our preliminary observations and suggestions regarding audit issues recommended for further examination as part of a detailed audit and analysis. Information used in our assessment included, business plans, performance reports and a limited examination of selected contribution agreement files and a preliminary review of key FEDNOR management controls and related risk assessments. Data collection for the preliminary survey took place during the period of April and May 1999.

The Preliminary Survey Report identified:

- Issues, which could be examined immediately, including:
  - Accountability and the Working Relationship between FEDNOR and Ontario Region.
  - Contribution Funding Administration Requirements and Approval Process and its Impact on Program Objectives.
  - Partnerships
- Issues to be examined in the future, including:
  - Organizational Structure
  - Strategic Planning and Goal Setting
  - Performance Measurement, Evaluation and Reporting
  - Communications
  - Support Functions.

#### PHASE II - Examination Phase

In discussion with FEDNOR's management and in accordance with departmental priorities, we agreed to place emphasis on the management of contributions and status of FEDNOR's implementation of its change agenda. Our general approach for the examination phase is described below.

- We conducted a detailed analysis of the administration of contribution agreements. This involved discussions on the intent of the program requirements and service delivery arrangements and a review of a selected number of files to assess the appropriateness of controls.
- We assessed the status of FEDNOR's implementation of its change agenda. This involved obtaining an update on organizational changes, planning and goal setting practices, communications and support functions and a review of the arrangements in place governing the provision of support services by Ontario Region to FEDNOR.

#### **Schedule**

The Preliminary Survey was conducted in April and May, 1999. At the end of the Preliminary Survey, we recommended that the detailed examination phase be deferred, to provide FEDNOR time to complete a number of changes it was implementing. In this way, the audit would be able to provide a status report on implementation of these changes. Accordingly, the detailed examination phase of the audit started in January, 2000 and concluded in March, 2000.



## **Audit Results**

In accordance with the general approach as agreed to for the detailed examination phase of this audit, we examined FEDNOR's approach to the management of contribution agreements and conducted such interviews and reviewed relevant documents, as needed, to assess the status of FEDNOR's change agenda.

### **Management of Contribution Agreements**

#### **FEDNOR's Clientele**

FEDNOR, like other similar development organizations, was created to provide stimulus to Northern Ontario's economic base. FEDNOR's interventions are based on an assessment regarding the opportunity presented by an initiative in terms of its furtherance of economic development in Northern Ontario. FEDNOR's clientele is primarily composed of organizations from the Not-For-Profit sector, including municipalities, CFDCs, Aboriginal organizations and communities, development corporations, and universities.

FEDNOR's clientele presents some unique challenges not normally faced when dealing with the private sector. The range of sophistication of client organizations is broad. Municipalities tend to have well-established administrative practices and are subject to annual audit. Other clients do not possess the same administrative capacity. Administrative capacity of clients can pose problems in the quality of information submitted to support a claim, the claim's preparation and the timeliness of its submission.

While FEDNOR's contribution agreements are designed to apply to corporations, a number of client organizations are not incorporated. To work around this issue, FEDNOR has encouraged recipients to partner with incorporated entities, such as a local municipality, who would sign the agreement on the recipient's behalf. In this case, the local municipality or representative would be bound to the terms and conditions of the agreement, in the event of default.

In some cases, such as when dealing with remote unincorporated Aboriginal communities, the contribution agreement has been drafted with an officer of the community, as signatory to the agreement. While this approach serves to identify a party to represent the recipient, enabling a contract to be established, it is open to question whether redress mechanisms provided for under the agreement are enforceable, in the event of default. This is because an officer draws his or her authority from the unincorporated entity. Legal status of such entities has an influence on cashflow requirements for related projects, as vendors have demanded payment in advance.

Given the number of potential public sector sponsors, there is always the possibility that in time and with additional effort, alternative sources of funding could be found. This makes it difficult to argue that, strictly speaking, any project with a Not-For-Profit entity would not proceed without FEDNOR's help. For such clients, the question is one of impact and timing. It is within this context that the question of incrementality is judged.

For many funding programs, acceptance of an application for a contribution hinges on the ability to secure funding first from another source. This can pose a dilemma for Not-For-Profit entities. While clearly other sources are evident, FEDNOR's support has served as a vote of confidence to the project proposal and enabled the client to lever FEDNOR's investment and obtain additional funding from others. It has also enabled the client entity to focus its energies on project implementation, rather

than on fundraising. In doing so, projects are allowed to come to fruition sooner and have a greater chance of success than otherwise would be possible.

### **An Overview of the Management Framework**

Through its contacts with Community Futures Development Corporations<sup>2</sup>, others at the local community level and with other stakeholders involved in the economic development of Northern Ontario, FEDNOR's officers have established a well-developed network and client base. Applicants submit project proposals to FEDNOR, typically after discussions have occurred to ensure that a given proposal fits with FEDNOR's mandate and that the proposal, as developed, is sufficiently well thought out and planned, contributing to its likelihood of success.

The decision to support a project proposal is made within the context of FEDNOR's programs and an assessment of the expected result or impact of the project in terms of providing a community, or the North in general, with the means to more effectively support or attract future economic activity.

Consideration is also made regarding how FEDNOR's financial support complements the support offered by others.

Examples of the projects sponsored by FEDNOR include:

- Telecommunications infrastructure projects.
- Feasibility and marketing studies.
- Tourism promotion.
- Opportunities for youth working within the economic development offices of a development corporation or local municipality.
- Sponsorship of networking events.

For projects greater than \$25,000, a FEDNOR officer prepares a detailed project assessment. Key information is transferred to a Project Summary Form (PSF). For smaller projects, only the PSF is required. This documentation is used to discuss the merits of a proposal and to support an officer's recommendation for financial support and document the project's approval by management. Once approved, letters of offer describing the terms and conditions of the contribution, including FEDNOR's contribution towards specific costs, is forwarded to FEDNOR's Director General, as a means to keep the Director General informed of developments and to obtain approval, if required. At this point, a letter of offer is prepared for the Director General's signature.

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<sup>2</sup> FEDNOR, through the Communities Futures Program, provides a forum for discussion and a means for community-based investment decisions on economic development at a local level. Such participation of local business interests in community-based investment decisions on economic development provides a basis upon which communities can take ownership and responsibility for the economic future of their communities on a sustainable basis. The benefits of the Communities Futures Program is in essence two-fold. First, it provides the means to develop the capacity for the promotion of local economic development initiatives. Second, it provides the seed funding needed by entrepreneurs to undertake their proposals.

Once the project is approved, financial officers within FEDNOR process claims arising against the approved project, including any advances, as recommended by the FEDNOR consultant/program officer and approved by management. The financial officers review supporting documentation provided and make adjustments to the claim for ineligible expenditures, by virtue of their inconsistency with the costs, as specified under the terms of the contribution agreement, or because the expenditures were made before the agreement took effect. Final payment is released upon completion of the project and the receipt of a recipient prepared project assessment report and additional evidence that attests to the installation or completion of project deliverables, including evidence of site inspections.

### **Our Audit Strategy**

The orientation of our work was forward looking, focusing on current and proposed management practices, as they relate to contribution agreements. Our sample was drawn from files, which were initiated during or subsequent to the 1998-1999 fiscal year. A total population of 458 FEDNOR Program files were identified within this period. A total of 49 project files were reviewed. Detailed reviews were performed of 29 files and another 20 files were subject to a general review. The general review was made in accordance with our project file checklist.

Files were selected on a judgmental basis in order to provide representation of files at different stages of development and a cross-section of the various funding programs administered by FEDNOR. Of the 29 files subject to detailed review: nine were closed files; three were open, but the final claim for payment had been received; and, 17 were in progress, some of which were not expected to be closed until 2001 or 2002. Six of the files subject to a general review were selected by management for our consideration, as they provided examples of “best practices” with regard to the management or administration of different aspects of the contribution agreement.

The files were selected from the following programs:

- Ontario Community Futures
- Networks for Northern Ontario
- Improved Access to Capital
- Enhancing Business Competitiveness
- Community Economic Development
- FEDNOR Contribution Programs.

### **Overview of Audit Results**

We concluded the following:

- Sufficient information was on file to assess the merits of a project proposal, and reasonable rationale had been provided by FEDNOR officers, when recommending a project for approval.
- Project approvals were duly documented and in accordance with relevant signing authorities.
- Signed letters of offer and amendments were on file. Amendments were appropriately justified.
- All claims reviewed were well supported.

- There is evidence of good financial stewardship being exercised by FEDNOR in the administration of its contribution programs.

Minor exceptions were observed and have been discussed with management for its follow-up.

Based on our review of files, we concluded that the reasons for an environmental assessment, as part of the project approval process, need to be better documented. We also concluded that opportunities exist to improve FEDNOR's administration of claims and its monitoring of projects. Both areas would benefit from better use of risk management techniques. The claims settlement process appears to be burdened by too much paper and imposes requirements on recipients, which do not adequately consider the recipient's risk profile. Project monitoring is acknowledged as an area of exposure, especially as it relates to more recent projects. The current reorganization by FEDNOR involves a reexamination of organizational arrangements and operating practices in order to improve client service and the effectiveness of project monitoring.

### **Detailed Observations from Our Review of Project Files**

Our file review involved an examination of files for signed letters of offer and related documents, consistency of decisions with program requirements and signing authorities, evidence to support payment of advances and to substantiate claims and the post-project assessments. Our detailed findings and recommendations, where appropriate, are as follows.

*Applicant letters of request for funding were found on file with some minor exceptions. Exceptions included:*

- The renewal of ongoing operating funds for the CFDCs. This is an ongoing FEDNOR commitment for which such a request is not applicable.
- For *Le Mouvement des Caisses*, the contribution pertained to the training of Caisse personnel to provide lending services, in accordance with the terms and conditions of the agreement between FEDNOR and the financial institution to improve small business access to capital.
- For one project file, which was less than \$20,000 an applicant letter was not observed. However, there was evidence of extensive consultation with the applicant on file to demonstrate the applicant's desire and need for FEDNOR's support.

***No Recommendation is required.***

*Applicants provided sufficient information to assess the merits of project proposals.*

The Project Summary Form (PSF) is a standard form used by FEDNOR to document the merits of a project proposal and the reasons for recommending a project's acceptance. For larger files, more detailed project assessments were observed. The PSF was used in all cases as a means to document formal approval of projects by FEDNOR's management.

***No Recommendation is required.***

*There was sufficient evidence on file of consultations, both internal and external prior to recommending a project for acceptance.*

***No Recommendation is required.***

*Project budgets were provided by the applicant for all cases. Cashflow statements were also provided, except when the project was too small to warrant it, with four exceptions.*

For all four files where exceptions were noted, FEDNOR's contribution was significant. In each case, FEDNOR's financial risk exposure was low. In one case, FEDNOR's contribution was about 4% of total funding provided by other stakeholders. The other three files pertained to telecommunications installation projects with CFDCs.

Cashflow information is useful to assess requests made by recipients for advances, to plan and forecast the timing of expenditures for resource management purposes and to assess a project's progress and to determine if it is in potential difficulty. Information on these exceptions was provided to management for its review and follow-up.

### ***Recommendation 1***

Cashflow information, in addition to project budget information, should be obtained for all major project-related contribution agreements.

### ***Management Response and Action Plan***

Cash flow information is monitored to ensure inclusion in all contribution agreements.

*Applicants provided FEDNOR with consent to access source documents and conduct audits on-site, if necessary.*

This is accomplished through a variety of means: the Letter of Offer includes a right of audit clause, the claim form establishes this right and a separate management representation form called the Acceptance Certificate also accomplishes this end. The Acceptance Certificate also requires a client representative to acknowledge the recipient's obligation to keep proper records and books of account. Historic practice required that such supplemental representations were made with each claim. FEDNOR management has stated that in future Acceptance Certificates will be requested from the client for the first claim only.

### ***No Recommendation is required.***

*Environmental Screening Reports were completed in all cases, except for one small contribution of \$2,400.*

Based on our review of files, we conclude that the reasons for calling a proposal a "project as defined in CEAA" and proceeding to complete a screening report, needs to be better documented. Also, we noted that on the project files reviewed, officers showed "not applicable" on the screening report under CEAA, because proposals did not represent "projects" as defined under the Canadian Environmental Assessment Act. Program Officers did not typically document the reasons for its ruling on "project". From our review, we concluded that the decision was made based on the nature of the work commissioned.

We were advised that FEDNOR was re-examining how its officers complete environmental screening assessment reports. In fact, at the time of our fieldwork, FEDNOR's officers were in training sessions on environmental assessments as required by the Canadian Environmental Assessment Act.

## ***Recommendation 2***

Project files should contain support for screening decisions, specifically, why a proposal is or is not a “project” under CEEA.

### ***Management Response and Action Plan***

FedNor Officers may require that an environmental assessment be completed as part of a project such as a feasibility study, where an assessment would not be required by the Canadian Environmental Assessment Act, if the Officer, on the basis of his or her knowledge, feels that adverse environmental effects are possible (if the study were to be followed by implementation) and that the application must be analyzed as if it were a project under CEEA, or if they view the assessment as necessary to effectively determine project viability.

FedNor continues to provide on-going training for staff on environmental assessments and to work with Departmental officials and other partners to improve assessment tools and procedures related to environmental assessments.

*Generally, risk assessments for claims verification purposes were performed, as contribution claims were submitted.*

Different risk assessment tools were observed in the different files and risk assessments did not occur for about a third (ten) of the files, which were reviewed in detail. Five of ten exceptions pertained to CFDCs. A risk assessment periodically occurs for CFDCs, which is used to establish FEDNOR’s monitoring plan. While the stated purpose of the risk assessment exercise is to determine the level of verification work required, we saw no evidence that the risk assessments had any bearing on the claims verification process or requirements of clients. For several files, we observed opportunities to use less intensive claims verification procedures than that which were actually applied.

Formal risk assessment is not performed as part of the approval process. We are recommending that a risk assessment should be performed prior to the approval of a project and should be a factor in decisions to accept a project proposal. The assessment should be used to determine claims verification strategy in discussion with the client. Performing a risk assessment at the time a claim is received provides FEDNOR with limited opportunity to adopt cost-effective approaches to substantiate claims.

Our detailed review of claims indicated that, in many cases, clients were asked to submit documentation, which was often difficult or costly to provide and inconsistent with the risk associated with the entity’s risk profile. For example, municipalities were asked to submit cancelled cheques. FEDNOR’s approach is one of direct verification. External auditors are not used to substantiate claims, even for projects with CFDCs, where audited financial statements are routinely provided to FEDNOR. We observed that several projects were subject to joint funding and believe that opportunities for cost savings exist, for FEDNOR, co-sponsors and clients through the development of a coordinated claims verification strategy, which would include greater use of external auditors.

FEDNOR recognizes that opportunities exist to improve its administrative practices in this regard and has initiated a task force, the Program Administration Improvement Team or PAIT to address issues related to claims administration and project monitoring. PAIT assesses not only current FEDNOR practice in comparison with departmental practices, but with comparable government organizations, such as Western Economic Diversification Canada, and Treasury Board policy and guidelines.

Recommendations made as part of this initiative are proposed for incorporation in the clauses of FEDNOR's letter of offer to recipients.

Risk assessment should also have a direct bearing on provisions for advances and project monitoring practices (see additional comments below). Once the risk is assessed, implications of the risks should be explained and a mitigation strategy proposed.

### ***Recommendation 3***

Risk assessment should be performed prior to the approval of a project and should be a factor in decisions to accept a project proposal. The assessment should be used to determine the claims verification strategy in discussion with the client. Once the risk is assessed, implications of the risks should be explained and a mitigation strategy proposed.

### ***Management Response and Action Plan***

FEDNOR is implementing the use of risk assessment tools recommended by the auditor. Assessments will be completed prior to project approval and will be a factor in determining the claims verification strategy. Once the risk is assessed, it will be discussed with the client and steps will be taken to mitigate the risk.

FEDNOR will consult with the department in implementing this recommendation. Full implementation planned for June 2001.

*Signed letters of offer and amendments, were observed on all files reviewed. Rationale for amendments was clearly documented and appeared reasonable.*

Parties to the agreements were incorporated entities, with the exception of a band council for a remote northern community. For two other files, incorporated entities acted on behalf of the direct clients of the contribution agreement. In the case of the Band Council FEDNOR was operating under direction that agreements with Band Councils could not be entered into. FEDNOR management has since implemented revised policies and procedures to allow for agreements to be entered into with Band Councils.

### ***No Recommendation is required.***

*The use of in-kind contributions was raised as a suggestion in FEDNOR's PAIT initiative.*

At the local government level, many examples can be found where in-kind contributions of recipients, such as made by community groups, are recognized for the purposes of determining the funding agency's contribution. In a similar fashion, by explicitly acknowledging in-kind contributions, FEDNOR would be able to increase the funding available to its contribution program recipients.

While the suggestion has merit and is consistent with practice at the local government level in dealings with Not-For-Profit, community-based entities, such contributions are inherently difficult to value or verify. Further discussions are required to determine:

- The circumstances, if any, under which the Department would be prepared to enter into contribution agreements on this basis; and,
- An appropriate monitoring strategy for such agreements to ensure that recipients meet their commitments.

***Recommendation 4***

In-kind contributions should be subject to further discussion and consideration by the Department, given FEDNOR's program objectives and clientele.

***Management Response and Action Plan***

FEDNOR agrees and will continue discussions with the department to encourage the inclusion of in-kind contributions as eligible costs.

*FEDNOR's recently adopted practice of attaching a covering letter of appreciation from the Department has served to delay the start of projects.*

While allowing the Department to extend its appreciation for the applicant's participation in FEDNOR's contribution programs and acknowledging the applicant's efforts to make a difference, this practice creates problems for both partners and FEDNOR from a resource management perspective. Allowing letters of offer to be delivered as soon as they are approved by FEDNOR would expedite the start of projects.

***Recommendation 5***

FEDNOR should take necessary steps to avoid delays.

***Management Response and Action Plan***

FEDNOR agrees with the recommendation.

*In promotion of FEDNOR's contribution programs, the Communications Group currently prepares a draft press release for every agreement.*

This is done to expedite the start of projects, as it provides the Department with the information needed to draft a letter of appreciation. It also provides sufficient information to allow preparing formal announcements or related events. For many of these projects, there is no formal announcement, currently rendering work done for related draft press releases of little value.

Recognizing the public needs for information and the need to promote the FEDNOR's programs, the Communications Group is considering the use of the Internet to provide summary information on approved projects. FEDNOR already provides summary information for the documentation of project approvals via the Project Summary Form. Opportunities appear to exist to make use of the PSF to make summary information available.

***Recommendation 6***

Steps should be taken to ensure press releases are prepared, only as needed, and that alternative approaches, such as offered by the Internet to keep the public informed of FEDNOR's work should continue to be pursued.

***Management Response and Action Plan***

FEDNOR's Communication Plan for 2000-01 includes new procedures for streamlining the criteria under which press release would be prepared.

FEDNOR will continue to use the Internet to keep the public informed and to develop on-line services.



*Ambiguity exists regarding whether FEDNOR contributions are toward events or specific expenditures made within a specific time frame.*

The current contractual framework appears to be unduly restrictive and does not adequately recognize the nature of FEDNOR's clientele and the time it takes to negotiate agreements. In addition, FEDNOR's value-added comes from mentoring and negotiations around its agreements. Its programs involve both capacity building and providing access to the funds needed by economic development initiatives.

While the timing of project activities may not be a factor in an initiative's success, for many projects, activities must be undertaken within a rigid time frame. In such cases, partners can be faced with the dilemma of delaying project work and risking the success of their initiative or performing work, as dictated by the project time line, and having costs disallowed by FEDNOR. Disallowance of otherwise eligible expenses could force the project to be scaled back, if additional funds cannot be readily secured. Otherwise, the principals involved could be faced with unexpected financial obligations.

#### ***Recommendation 7***

FEDNOR's standard letter of offer and claims verification practices should be reviewed and amended, if necessary, to avoid the unintended rejection of project-related expenses.

#### ***Management Response and Action Plan***

FEDNOR is currently reviewing standard letters of offer and will have them reviewed by the department before June 30, 2001

FEDNOR will continue to allow project related expenses from the date of application on all approved projects.

*While advances were made consistent with policy guidelines, we are concerned that for new clients, full advances may not be prudent.*

We observed three contribution agreements, for which:

- FEDNOR did not have previous experience;
- The project cashflow front-ended costs to the first quarter;
- Significant advances were made, upon request by the recipient and in accordance with cashflow; and
- The receipt of claims for costs incurred are now overdue.

The projects involved the purchase of goods and services by recipients, including consulting services for marketing a new tourist attraction, installation of a LAN and associated training, and the installation of telecommunications infrastructure for a remote community. Given the extent of the advances made, there appears to be little financial incentive for the recipient to submit a claim for the balance of amounts owing in a timely fashion.

This practice leaves FEDNOR open to exposure of default by the recipient. The practice to issue full advances to new clients, especially when project whose costs are front-end loaded, should be re-examined. In the case of the reimbursement of major expenses, the timing of the advance could be

directly tied to invoicing by the recipient's supplier, or alternatively, could be made directly to the vendor by FEDNOR.

***Recommendation 8***

The decision to advance funds and the amount to be advanced should be based on an assessment of the risk of non-performance or default.

***Management Response and Action Plan***

Implementation of risk assessment at the project evaluation stage, by June 2001, will ensure the appraisal of increased risk due to up-front cash flow and that alternative contract arrangements are considered.

*Holdbacks were applied in accordance with policy.*

Our sample included a limited number of claims for which holdbacks applied. For the closed files reviewed, the final claim was paid upon receipt of project reports and evidence of completion of the project in accordance with the terms of the contribution agreement.

***No Recommendation is required.***

*Project assessments are prepared before closing a file.*

FEDNOR prepares a project assessment and evaluation report following the completion of tasks and deliverables, as described in the contribution agreement. FEDNOR focuses on project outputs, rather than outcomes or impacts. Project monitoring is limited to receipt of such project reports, except for the CFDCs. For CFDCs, monitoring involves attendance at board and other committee meetings and the receipt and review of minutes, the annual business plan, quarterly statistical reports and audited financial statements. For additional details on the management framework in place for CFDCs, please refer to Appendix A.

Project monitoring requirements are dependent on the nature of the project and its deliverables as rendered up to the receipt and acceptance of the final claim. Generally, the evidence obtained and documented on file attests to the delivery of project outputs, as promised in the contribution agreement. Project monitoring, with the exception of the ongoing monitoring associated with the CFDCs, appears to be limited to outputs. On-site visits, especially to remote locations, are not occurring, making it difficult to ensure that deliverables, such as telecommunications equipment, are installed and being used as intended.

Follow-up and assessing the impact or outcomes resulting from contributions is recognized as needing improvement. The recent reorganization of FEDNOR to a geographic delivery model and the establishment of Payments and Monitoring Officers, responsible for financial aspects of contribution agreements, should have a positive impact on the effectiveness of monitoring activity and FEDNOR's capacity to provide assurances regarding value-for-money. For both CFDCs and contribution agreements related projects, project monitoring needs to focus more towards outcomes (see additional comments on *the Position of the Monitoring and Payments Officer* and on *Performance Measurement and Reporting* in the next section of this report). For CFDCs, comparative analysis and assessments should also be made.

### ***Recommendation 9***

Project monitoring practices should ensure on-site visits occur, as required, and assess outcomes resulting from contributions, in addition to outputs or deliverables.

### ***Management Response and Action Plan***

An evaluation framework, which includes assessment of project outcomes, has been developed and is being implemented for completion by March 2002. FEDNOR has contracted for an independent review of current and recently completed projects. This review will be completed by the end of August 2001.

Monitoring & Payment Officers will perform future on-site visits as part of effective monitoring practices.

*For repayments, all but one file reviewed pertained to non-repayable contributions.*

In the one file that was repayable, a pre-commercial research and development project, a repayment schedule had been prepared. The project was still in progress and the repayment period had not yet started.

***No Recommendation is required.***

### **Project Specific Observations**

#### *FEDNOR's Contribution for the Frame Relay Infrastructure*

We reviewed the umbrella arrangement governing the multi-contribution agreements with CFDCs across Northern Ontario for the installation of the frame relay infrastructure. We found FEDNOR's to be innovative, in that the contribution agreement was structured in such a way as to provide a financial incentive for the service provider to establish the infrastructure needed to support Internet access by remote communities, without subsidizing the provider's costs of entry into a commercially viable market. FEDNOR's contribution was based on the use made of the infrastructure. The greater the use, the smaller FEDNOR's contribution to the point where no contribution would be paid. This approach recognizes the Crown's desire to promote connectiveness of Canadian communities, while avoiding the creation of a subsidy to a vendor for commercially viable services.

***No Recommendation is required.***

#### *FEDNOR's Contribution to an Equity Fund*

FEDNOR together with Aboriginal Business Canada (ABC) have entered into an agreement, as of March 31, 1999, with an investment company to establish an equity fund. The investment company is wholly-owned by an Aboriginal Capital Corporation. Industry Canada's total contribution under this agreement is \$750,000. FEDNOR's share is \$500,000 and ABC provided the balance. Eligible costs included a maximum of \$150,000 for the administration of the equity fund or 20% of investments made. This would make, at least, \$600,000 available for equity investments. We understand that this is a pilot project and a unique situation.

Investments can be made in joint ventures that would create employment opportunities or wealth for the benefit of Aboriginal people. The investment company's application indicates that it acts as an

agent in pursuit of joint venture opportunities and as a consultant to advise Aboriginal partners on the feasibility of proposed business ventures and on drafting of shareholder agreements. To quote:

“[The investment company] could provide the “up-front” equity for the native partners sufficient to close transactions. Arrangements via a shareholders agreement would be put in place that would allow the native entrepreneur(s) to repurchase [the investment company’s] shareholdings under prearranged conditions.

[The investment company] will, ideally in all cases, be granted a minority position for its equity participation and would not be involved in the day to day activities of the joint venture. Nevertheless, it will ask for either a seat on the board (legal implications must be considered) or as an “observer” to be in a position to properly monitor its investments. When our entrepreneurs exercise their repurchase option, [the investment company] will provide our native partners, on an exclusive basis, supported by the proper documentation at closing, the opportunity to repurchase [the investment company’s] equity ownership in all its investments within a reasonable time frame (i.e. 3 to 5 years).”

While there are no additional restrictions on ABC’s contribution, FEDNOR has required that its contribution must also pertain to Northern Ontario. Any unused funds would be refundable to the Crown at year-end. It is our understanding that the fund’s general manager is not an employee of the company and receives fees for his services, as the fund’s investment manager. The investment manager, described as an experienced former investment banker, has other clients and recently moved to Southern Ontario. We further understand that FEDNOR would not have invested in this entity without the participation of the investment manager.

The agreement calls for the submission of quarterly reports and financial statements within 90 days of its year-end, which is March 31<sup>st</sup>. In addition, the ABC agreement requires quarterly interim financial statements and a copy of the annual audited financial statements. In order to assess the impact of the contribution, the FEDNOR agreement also requires information on the number of joint ventures completed in Northern Ontario, the wealth created from these equity positions, and job creation within these companies for Aboriginal people. The investment manager has provided narrative information summarizing the efforts in pursuit of investment opportunities and the value of investments. While this information provides some assurance that funds are being used as intended, the information is limited.

In order to assess the performance of this contribution, additional information is needed. Receipt of the audited financial statements for the year-ending March 31, 2000 should confirm the status of investments. It should also provide information on fees for consulting services rendered (both as collected by the investment company and paid to the investment manager) and enable FEDNOR to assess the expenses associated with the fund’s administration. Additional information is needed on the nature of the investments, their status and performance in accordance with FEDNOR’s evaluation criteria (benefit to Northern Ontario and creation of jobs and/or wealth for Aboriginal people). While we understand that FEDNOR reviews investments after they are negotiated for consistency with the agreement’s intent, information on the joint ventures’ progress is needed to fully assess the cost-effectiveness of this innovative approach.

The investment company's stated role is that of a middleman, providing Aboriginal partners with access to capital needed to close a deal and counselling to the joint venture, contributing to its success. Accordingly, we would expect that the equity agreements made by the investment company would identify the Aboriginal partner(s) and would be supported by clauses or collateral agreements, describing the prearranged conditions to repurchase the investment company's interest and steps to be followed to exercise that option. Further, given the investment company's stated objectives, we would expect to see the targeted internal rate of return, stated as being at a minimum of 20%, built into the repurchase options. There is some indication that investments made by the equity fund are structured on this basis and are being repurchased by Aboriginal partners. However, additional information is needed to understand how the actual agreements are structured and to determine the extent to which Aboriginal partners are involved.

### ***Recommendation 10***

Because this is a pilot project, and represents a different approach to promote economic development, we recommend that FEDNOR take a more proactive role in the administration of this project. In addition, given the potential application elsewhere, as an alternative to other community-based funding activities, this project should be subject to a formal review.

### ***Management Response and Action Plan***

The project referred to in this recommendation is a joint project with Aboriginal Business Canada. FEDNOR will perform a detailed review, as suggested by the auditors, subsequent to receipt of the audited financial statements. FEDNOR will continue to monitor this project to ensure all conditions of the agreement are met and will conduct a formal evaluation by September 2001 after completion of the project in March 2001.

## **A Status Report on FEDNOR's Change Agenda**

### **Overview of Audit Results**

Progress has been made by FEDNOR regarding:

- *Design of its revised organizational structure and the classification of positions. Positions are in the process of being staffed.* Additional work remains to implement the revised organizational structure, including establishing the Policy and Planning function and clarifying the role, responsibilities and working relationships, as they relate to the position of Monitoring and Payments Officer.
- *Development of performance measurement and reporting practices, as it relates to outcomes and benefits derived from contribution projects.* Additional work remains in the development of the performance measures and reporting practices as it relates to the assessment of behavioural change, the ongoing monitoring of a project's status, during its implementation, and the evaluation of projects outcomes over time.
- *Improvements in general management practices, including business planning, reporting of achievements and financial management* Increased involvement of program managers is required for variance analysis and the projection of program funding requirements, especially as it relates to contribution funds.

- *Staffing and augmenting its Communications function.*
- *Development of a Memorandum of Understanding with the Department's Ontario Regional Office.* The service agreements required to support the memorandum of understanding with the Ontario Region remain to be drafted.

Detail on progress is documented below and includes suggestions for FEDNOR's consideration.

### **Reorganization of FEDNOR**

The FEDNOR reorganization is conceptually strong from a client service and program management perspective. A revised organizational structure is currently being implemented, which is based on a geographic delivery model. The reorganization will provide FEDNOR with three offices, which are capable of delivering the full complement of FEDNOR's programs. Its structure provides for continuity of relationships at a community level, such that clients served by a geographic area should be able to readily identify with specific individuals as their client representative. This offers FEDNOR the opportunity to develop a stronger sense of client needs and opportunities, strengths and weaknesses, not only from an economic development perspective, but in terms of a client's administrative capacity to manage projects, funds and submit properly completed claims.

At the time of our field work, the new organization had been approved and the positions had been classified, with the exception of about five support positions. Position descriptions in UCS format have been drafted and positions are in the process of being staffed. The general level of classification provides a certain degree of flexibility to allow for the rotation of staff within program areas and provides a basis for succession planning from a program officer to area office manager.

### **The Policy and Planning Function**

The new organizational model for FEDNOR establishes a fully staffed Policy and Planning function with responsibility for the design and evaluation of program delivery strategies. Sector specialists would reside within Policy and Planning and provide technical advice to program officers. At the present time, the function has not been staffed. While in designing the new organizational structure considerable thought has occurred regarding the role and responsibilities of program officers, the working relationships between program officers and policy and planning officers, including the potential of the rotation of program and policy and planning officers, has not been developed.

Establishing this function provides a stronger basis for environmental scanning, the identification of opportunities and strategic planning, as well as evaluation of the effectiveness of FEDNOR's programs, contribution agreements and program delivery strategies. But in order to do so effectively requires feedback on the application of program delivery tools and strategies and on project results. This information, if tapped, can be used for strategic purposes, by proactively suggesting opportunities to FEDNOR's clientele, such as CFDCs, and used to revise and improve FEDNOR's program delivery strategies and practices.

## **Position of the Monitoring and Payments Officer**

Each of the three main area offices has been allocated monitoring and payments (M/P) officers. It is expected that these senior officers will fulfill a variety of duties related to claims verification and project monitoring, enhancing FEDNOR's ability to assess the extent to which project objectives have been achieved. Geographically based M/P officers also offers the opportunity of improved turnaround time in claims verification and processing.

Under one scenario, once the program officer has brokered an agreement and a signed letter of offer is in place, the M/P officer would take on responsibility for the file. Our concerns with this approach relate to both client service and effectiveness of monitoring. A M/P officer is capable of interpreting contribution agreements and administering claims, as is current practice. Splitting responsibility for monitoring and managing the agreement away from the program officer, after the agreement is signed, could dilute FEDNOR's ability assess of the program delivery strategies and its ability to manage client relationships.

The program officer, having discussed a client's project proposal and recommended FEDNOR's approach in support, has an in-depth understanding of the spirit and intent of an agreement and its relationship to program objectives and delivery strategies. By being able to follow a project through to its delivery and to continue to assess or observe the benefits derived from a project after its completion, the program officer is in a good position to assess performance from both the perspective of the client's contribution and FEDNOR's program design.

From a client perspective, when things do not go according to plan, the program officer, having negotiated the underlying basis for FEDNOR's support, is able to assess and recommend amendments to the agreement, as they may relate to eligible expenditures or their timing. If no amendment is warranted, then the program officer is able to explain FEDNOR's position to the client, again based on the agreement, as negotiated. This allows the program officer to learn first hand how clients interpret agreements, when differences of interpretation or disputes arise.

As an alternative approach, where responsibility for a file would be transferred to the M/P officer, a team approach could be considered, whereby the program officer and the M/P officer would be jointly involved in the negotiation of agreements and ongoing management. From a client management perspective, the program officer would be responsible for ongoing communications with the client. The M/P officer would be a resource to the program officer providing support in the financial risk assessment of project proposals, development of both a claims verification and monitoring strategy (which would be incorporated in the agreement), and processing and verification of claims.

The position of M/P officer, as described by FEDNOR, is primarily a financial position. As the senior on-site financial officer for an area office, the position offers the potential of serving the broader financial management needs of the area office's manager and FEDNOR's interest to improve its overall management of resources. Consideration should be given to align M/P officers with FEDNOR's senior financial officer, either on a line or functional basis. At a minimum, the senior financial officer should be involved in the selection of M/P officers.

## Performance Measurement and Reporting

Additional work needs to be done in obtaining information on the results of projects and consolidating and reporting project-based information in a manner that supports ongoing program evaluation and strategic planning. Towards this end, FEDNOR has proposed the development of an ongoing monitoring and evaluation system (OMES), which could complement information contained in the departmental system, CMIS. CMIS is seen as being limited in its ability to capture information on outcomes, beyond assessments of jobs created. The OMES is intended to measure other outcomes, such as behavioural change, as recommended by FEDNOR's evaluation framework.

A draft Project Outcome and Evaluation Score Sheet has been developed, which would be used to capture data on projects related to outcomes. The "score sheet" is designed to ease its completion, such that it involves:

- Yes or no responses to describe the nature of the project's impact and determine whether the local MP was informed of the project results; and,
- A five-point scale to evaluate the effectiveness of the project in terms of its overall impact; the benefit to the recipient, the surrounding community, and the Northern Ontario; and, the project's management and administration, including recognition of FEDNOR's contribution.

This approach directly addresses the question of a project's impact and lends itself to the calculation of a measure, upon which the relative success of the project could be assessed. However, this approach raises questions on consistency of evaluations across FEDNOR and interpretation and use of the information, either when comparing the results of one project to another or evaluating FEDNOR's overall contribution to the North. The score card is designed as a point-in-time, post-project evaluation tool. As such, it does not directly contribute to the ongoing monitoring of the project, during its implementation, nor to the evaluation of outcomes into the future.

We compared the score card to practices of an international development aid agency that had adopted a results-based management approach for its development projects. This entity's score card accommodated narrative assessments, as it related to expected outcomes. Expected outcomes were developed as a result of strategic objectives set by the agency and negotiations with recipients and host countries regarding how the agency's objectives and project proposals complemented the host country's priorities, capabilities and specific expectations of the project, itself. Project reporting accommodated both interim progress reporting and post-completion evaluation. Program and project managers found that reporting on this basis, allow them to answer the following questions:

- ▶ What is it about?
- ▶ What are we trying to achieve?
- ▶ Are we on track?
- ▶ How do we know?
- ▶ If the project is in difficulty, what is proposed to resolve?

The design of FEDNOR's score card does not lend itself to measurement of behavioural change or, simply stated, learning. Given that FEDNOR was created to promote the objective of sustainable, self-reliant communities in Northern Ontario, use of learning plans and related performance appraisal



methodology may offer opportunities for both planning and assessment/evaluation purposes, especially as it relates to communities.

Regarding the CFDCs, given the number of CFDCs supported by FEDNOR, comparative analysis of performance in key results areas could identify opportunities for the exchange of ideas between the CFDCs and more active dialogue between FEDNOR and this client group.

### **General Management**

In terms of operational planning and reporting practices, FEDNOR prepared a mid-year report documenting its achievements to September 30, 1999 and provided a detailed description of its accomplishments in comparison with stated commitments and performance measures. Business plans for the coming fiscal year were submitted in February 2000.

In discussion of financial management practices, free balance information is made available to managers on a monthly basis. While variance analysis of expenditures has been led by Finance, the division has been working with operational management to take on a greater role in this regard. Lapsing of funds was not stated as a problem for FEDNOR. However, the recent increase of program funding and the time required to staff and train new staff to carry-out FEDNOR's expanded role may pose a challenge for FEDNOR, as it relates to program spending in the coming year.

### **Communications Function**

The Communications function appears to be operating effectively and operating in an integrated manner, in support of the Department. With the creation of a Secretary of State for FEDNOR, the Communications function has experienced significant growth in demand for its services in response to the ongoing information needs. FEDNOR uses departmental correspondence management systems to log and scan correspondence, cross-reference enquiries to similar or related enquiries, task officers to obtain required information and follow-up to ensure timely response.

### **Memorandum of Understanding with Ontario Region**

FEDNOR has a Memorandum of Understanding (MOU) in place with the Department's Ontario Regional Office. The MOU covers support services to be provided by the Ontario Region to FEDNOR. Related service agreements for human resources, finance, administrative and informatics services remain to be drafted and agreed to. The MOU also delineates areas of primary and shared responsibilities and describes the arrangements to ensure each party is kept current on issues of mutual interest. There are also provisions for the management and review of the MOU.

The MOU is supported by two annexes. The first provides details on the human resources services, for which a service agreement is needed. The second describes Ontario Region's participation in the management of the Community Futures program.

## **Management Framework for Community Futures Development Corporations (CFDCs)**

CFDCs manage loan portfolios. From time to time, capital injections are required to replenish funds eroded through loan losses. FEDNOR is not directly involved in the operation and decision-making activities of the CFDC, but maintains an ongoing relationship with the CFDCs, monitoring their loan operations and partnering with them in the delivery of other FEDNOR programs.

A FEDNOR officer is assigned to each CFDC. Monitoring activity is determined based on a risk assessment of the CFDC. Generally, monitoring activity involves the attendance by the officer of CFDC meetings. These include board meetings and separate loan review committee meetings.

At these meetings, discussions include the status of the loans, arrears, pending legal action and collection activity. While FEDNOR officers have access to information used in the assessment of loan applications, this information is not included in FEDNOR files because of the concerns for privacy.

In monitoring a CFDC, FEDNOR officers seek assurance that the CFDC is operating consistently with its mandate, such that it is actively and responsibly seeking opportunities to make loans within its service area. The officer does not comment on the merits of individual applications or the viability of the businesses *per se*. However, if the officer is aware of information of relevance, then that information is shared.

The CFDCS have their own loan policies and procedures. Fund managers/loans officers are expected to possess an appropriate background in banking and to actively work with their clients. In the assessment of applications, CFDCs require a variety of information including references and credit rating, business and product profiles, business plans, cashflows and proforma financial statements.

To support ongoing monitoring of the CFDCs, FEDNOR has provided each of the CFDCs with a common software. This software captures information on the loans, value and number of loans, information on consultations related to loans, and loan loss experience. This software supports quarterly and annual reporting requirements for both the CFDCs and FEDNOR. In addition to the annual reporting requirements by FEDNOR of the CFDCS, officers receive annually audited financial statements.

FEDNOR directly contributes to the sharing of lessons learned and networking between the CFDCs through ongoing discussions with the CFDCs and sponsoring of an annual conference for CFDCs.