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# **Audit of the Structured Financing Facility (SFF) Program**

## **Final Audit Report**

May 2008

Recommended for Approval to the Deputy Minister  
By the DAC on May 27, 2008  
Approved by the Deputy Minister on May 30, 2008

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## 1.0 Executive Summary

### 1.1 Introduction

The initial Structured Financing Facility (SFF) Program was developed in 2002 as a five-year, \$150 million program designed to stimulate economic activities in the Canadian shipbuilding and marine industry by providing financial assistance to buyers and lessors of Canadian-built ships. The Program helped to buy down the interest rate of the loan used to finance the purchase or lease. Between 2003 and 2007, a total of \$84 million was re-allocated due to budget limitations and re-profiling, bringing the total initial SFF Program approved contribution funding to \$57 million. The Program was renewed in June 2007, with funding of \$50 million to help ensure that Canadian shipyard capability exists to meet federal procurement and maintenance needs in 2009 and beyond.

The Audit and Evaluation Branch's (AEB) 2005-2008 Multi Year Risk-Based Audit Plan, approved by the Departmental Audit and Evaluation Committee (DAEC) includes an audit of the SFF Program. The objective of the audit was to provide assurance to senior management that sufficient and appropriate practices and procedures are in place and undertaken to ensure that the SFF Program as implemented is consistent with government and departmental objectives and priorities, and that the Program addresses actual needs.

The scope of the audit covered both the initial and the renewed SFF Programs from their inception through to February 2008.

### 1.2 Main Findings

It is recognized that key lessons learned from the initial SFF Program were identified and acted upon by management to improve the design and delivery of the renewed Program. Specifically, the following improvements have been made: the renewed Program's Terms and Conditions more clearly define eligible expenses and specifically prohibit the ability of purchasers to act as project managers; recipients are required to report project performance against pre-defined criteria using qualitative information; program officers are required to conduct site visits for monitoring purposes during the application, project implementation, and project completion phases; and project approval decisions are documented using assessment criteria from the Project Summary Form (PSF). In addition, our interviews with representatives of Program management indicate that ongoing efforts are made to further improve the efficiency and effectiveness of the Program as it continues to evolve.



Two main findings were identified through the audit:

### ***Internal Control***

- Finding 1.0 - Information in some project files was not supported by sufficient back-up documentation and/or was not in accordance with documented Program procedures.
- Finding 2.0 - The date of receipt of a completed application under the Program is not clearly defined. This may lead to difficulties in substantiating the timing of applications in the instances where more than one project of similar merit is submitted for project funding under the same time period.

## **1.3 Recommendations**

To address the findings described above, the following recommendations are provided:

- Recommendation 1.0 - The Director, Defence and Marine Directorate, should ensure that expected Program procedures, including the expected and acceptable level of file documentation, are clearly defined and communicated and that an approach be implemented to ensure quality control over compliance with established procedures.
- Recommendation 2.0 - The Director, Defence and Marine Directorate, should ensure that items required to fully complete an application are documented and referenced by program officers on file, and should ensure that applicants receive a formal notification of the date their application is considered completed

## **1.4 Statement of Assurance**

*In my professional judgment as Chief Audit Executive, sufficient and appropriate audit procedures have been conducted and evidence gathered to support the accuracy of the opinion provided and contained in this report. The opinion is based on a comparison of the conditions, as they existed at the time, against pre-established audit criteria. The opinion is applicable only to the entities examined and within the scope described herein.*

## **1.5 Audit Opinion**

*In my opinion, the SFF Program has minor weaknesses, with low risk exposures, related to control processes of the Program that require management attention.*

---

Richard Willan  
*Acting Chief Audit Executive, Industry Canada*

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Date



## 2.0 About the Audit

### 2.1 Background

In October 2000, the Minister of Industry Canada commissioned the Industrial Marine Partnership Project. The project consisted of an industry-labour National Partnership Project Committee mandated to develop measures to improve competitiveness, innovation, and growth within the Canadian shipbuilding and marine industry. In response to the recommendations of the Committee, the federal government developed the *New Policy Framework for the Canadian Shipbuilding and Industrial Marine Industry: Focusing on Opportunities* which was released in September 2001. One of the Policy Framework's core elements was the Structured Financing Facility Program (SFF Program). The SFF Program supports Industry Canada's strategic objective of competitive industry and sustainable communities by ensuring a more sustainable economic and social future for Canadians.

#### ***Initial SFF Program – 2001-2007***

The initial SFF Program was developed as a five-year, \$150 million program covering grant and operating expenses, designed to stimulate economic activities in the Canadian shipbuilding and marine industry. The initial SFF Program provided financial assistance to buyers and lessors of Canadian-built ships by helping buy down the interest rate of the loan used to finance their purchase or lease.

The initial SFF Program offered three (3) elements of support: Interest Rate Support (IRS); Credit Insurance Contribution; and Credit Insurance Support. In practice, only the Interest Rate Support component was used under the initial Program. The Interest Rate Support component is a non-repayable contribution to be used against overall interest costs up to 15% of the purchase price of new Canadian-built vessels. In accordance with the federal government's stacking provision requirements, the buy-down of interest or leasing costs could not exceed 75% of total interest or leasing costs.

At the time of the audit, a total of 36 projects had been approved under the initial SFF Program, totaling \$57 million in approved contribution assistance. Between 2003 and 2007, a total of \$84 million was re-allocated due to budget limitations and re-profiling, bringing the total initial SFF Program approved contribution funding to \$57 million.

#### ***Renewed SFF Program – 2007-2013***

In June 2007, the SFF Program was renewed by Treasury Board with an additional \$50 million in funding to cover grant and operating expenses through to fiscal year 2011. The SFF Program's objectives were revised to help ensure that Canadian shipyard capability exists to meet federal procurement and maintenance needs in 2009 and beyond. The renewed SFF Program is intended to help maintain a competitive environment as required by the federal government's *Buy Canada* policy.



At the time of the completion of our audit fieldwork, a total of 2 projects had been approved under the renewed SFF Program for a total of approximately \$14M in approved contribution assistance.

Eligible applicants under both the initial and renewed SFF Programs must be purchasers or lessees of a vessel or offshore marine structure. The payment for the newly built or modified vessel or offshore marine structure must be financed by a lender or lessor who receives the SFF contribution to reduce the applicant's interest or leasing costs.

The SFF Program operates under the Aerospace, Defence and Marine Branch within Industry Canada's Industry Sector. The SFF Program is directed and led through the Defence and Marine Directorate within Industry Canada headquarters located in the National Capital Region.

## 2.2 Objective

The objective of the audit is to provide assurance to senior management that sufficient and appropriate practices and procedures are in place and undertaken to ensure that the SFF Program as implemented is consistent with government and departmental objectives and priorities, and that the Program addresses actual needs.

## 2.3 Scope

The scope of the audit covered both the initial (2001-2007) and the renewed SFF Program (2007-2013) from their inception through February 2008.

## 2.4 Methodology

The approach to the audit consisted of the following:

- Documentation was examined to obtain an understanding of each Program's current risk management processes, governance structures, and internal controls;
- A sample of twelve (12) projects from the initial Program and two (2) projects from the renewed Program were selected and examined for compliance with Program policies and procedures. The sample of initial Program projects represents 52% of total federal funding approved under the Program and was judgmentally selected based on materiality and geographic coverage. The sample of renewed Program projects represents 100% of approved projects under the renewed Program as of the date of completion of the audit fieldwork;
- Fourteen interviews (14) were conducted with representatives from the Program, the Program Services Directorate, and selected successful applicants; and
- The information gathered through the above procedures was analyzed against the audit criteria contained in Appendix A. Criteria were based on relevant legislative and regulatory requirements; standards, policies and practices followed by Industry Canada in the management of the Program; as well as relevant Core Management Controls as established by Treasury Board.



## 3.0 Findings and Recommendations

### 3.1 Introduction

This section presents detailed findings from the audit of the initial and renewed SFF Program. Findings are based on the evidence and analysis from both our initial risk analysis and the detailed audit conduct. It is recognized that key lessons learned from the initial SFF Program were identified and acted upon by management to improve the design and delivery of the renewed SFF Program. These are summarized in Appendix B.

In addition to the findings presented below, observations of conditions that were non-systemic and of low materiality and risk and areas for improvement for the renewed SFF Program have been communicated to management in the form of a Management Letter for their consideration.

### 3.2 Governance

Overall, the combination of processes, procedures and guidelines in place provides adequate governance. The results of the audit raised minor issues related to the governance of the SFF Program and are discussed in a Management Letter.

### 3.3 Internal Control

SFF Program management has defined and documented expected procedures through each phase of a project's life cycle. This documentation has been supplemented by a number of interpretation guidelines to help enable consistent policy interpretations, including guidelines related to calculating effective interest rates and stacking. Management has also developed and implemented a number of checklists and forms to support consistency and due diligence in key phases of the project life cycle, including an Officer Assessment Checklist, Interest Rate Support Eligibility Checklist, Proposal Template, and Shipyard Impact Assessment Report. Management has not adopted the use of a Claims Review Checklist as recommended in the Grants and Contributions Framework – March 2007 project due to the low volume of claims and lower risk nature of claims under this Program. However, they have defined expected procedures to perform during the claims review process.

The SFF Program's internal controls are further supplemented by support from the Department's Programs and Services Directorate (PSD) in a number of areas, including the provision of advice in the assessment of the Project Summary Form; development of Program terms and conditions; and developing Program policies and procedures. In addition to this, PSD and the Program Services Board review all applications as part of the project approval process.

#### **Finding 1.0: Incomplete file documentation**

Information in some project files was not supported by sufficient back-up documentation and/or was not in accordance with documented Program procedures.



The SFF Program structure allows for flexibility in dealing with issues given the small number of dedicated officers within the Program. Program officers indicated that while SFF Program procedures were documented up front, changes were made in practice when some documented procedures (such as providing initial letters to applicants) were deemed unnecessary or were not perceived to provide additional value.

The risk of the disparity between documented Program procedures and the procedures followed in practice is that control activities may become inconsistent over time, may create difficulties in transferring SFF Program and project knowledge to new resources and in ensuring consistency in Program delivery approaches. This will become increasingly important as new employees are transitioned to support the Program in the regions.

While program officers were able to identify and discuss the rationale behind decisions on the files examined, the lack of supporting documentation on file reduces the ability of management to demonstrate compliance with the Policy on Transfer Payments and other government and IC directives and related procedures for grant and contribution programs.

Our review of a sample of initial and renewed Program project files identified the following examples of incomplete file documentation:

*a) Instances of non-compliance with established procedures:*

- In 58% of initial SFF Program files examined, there was no signed off confirmation from the lender acknowledging full disbursement of the loan to the borrower. This confirmation is expected to be filed with claims submitted as an independent form of evidence supporting the amounts disbursed, and ultimately the amount of interest to be reimbursed by the Program. It is noted that in cases where this form was missing in claims submission, supporting invoices were provided and the original loan agreements was on file to support the amounts agreed to be disbursed. However, invoices could not be easily tied to claim amounts in all cases, and the confirmation from the lender provides a stronger source of evidence of actual funds disbursed to the borrower.
- All but one file was missing an “Acknowledgement of Information Received” letter, which is intended to inform the applicant that project information has been received and a project officer assigned to the applicant.

*b) Instances of incomplete file documentation:*

- In 33% of the initial SFF Program project files reviewed, costs in the application did not agree with the cost information in the Project Summary Form (PSF) and there were no supporting schedules to reconcile the costs. Program staff informed us that changes in anticipated costs were made to reflect more complete and reasonable cost estimates in the PSF. However, there was no support on file to indicate the rationale for the changes.
- Verification reports that were on file related to on-site verification activities performed by program officers. These reports included the dollar value of activity examined and findings, but did not detail the specific procedures performed and were not supported by clear and concise documentation evidencing the activities that were performed.



The primary risk in the above noted discrepancies lies in the lack of a complete “audit trail” for independent or new personnel to understand the rationale and timing of decisions on file. However, the risk of incorrect or overpayments under this Program is considered to be low given that loan agreements and supporting invoices are on file, and in cases where program officers questioned the validity of information received, desk verification reviews and/or site visits to the shipyard were conducted to obtain comfort over the reasonableness of costs incurred in the building or restoration of the vessel.

### **Recommendation 1.0**

*It is recommended that the Director, Defence and Marine Directorate, ensure that expected SFF Program procedures, including the expected and acceptable level of file documentation, are clearly defined and communicated and that an approach be implemented to ensure quality control over compliance with established procedures.*

### **Finding 2.0 Date of receipt of completed applications is not clearly noted.**

The date of receipt of a completed application under the Program is not clearly defined. This may lead to difficulties in substantiating the timing of applications in the instances where more than one project of similar merit is submitted for project funding under the same time period.

Our file review noted that program officers do not indicate the date of receipt or acceptance of an application by a date stamp. Project officers currently track the date when they consider the applications as being complete in a spreadsheet but there was no consistent evidence on file with respect to when applicants had been informed that their application was considered complete.

As funding under the SFF Program becomes more limited, the Program may be faced with situations in which more than one application for funding is submitted during the same time period. This will require a decision to approve some of the projects and reject others based on funding available. However, since applications are not assessed based on merit, but rather are purely assessed against Program eligibility criteria, the date of submission of a completed application will be critical to defend project approval decisions.

### **Recommendation 2.0**

*The Director, Defence and Marine Directorate, should ensure that items required to fully complete an application are documented and referenced by program officers on file, and should ensure that applicants receive a formal notification of the date their application is considered completed.*



### **3.4 Risk Management**

Overall, processes to identify, assess and control potential events or situations are managed to achieve the organization's objectives. The results of the audit raised minor issues related to the risk management of the SFF Program and are discussed in a Management Letter.



## Appendix A: Audit Criteria

<i>Audit Criteria</i>
<b><i>INTERNAL CONTROLS</i></b>
<i>Staff and management who are responsible for program delivery have the required skills, knowledge and capacity.</i>
<i>Proper financial controls have been designed and implemented to help ensure that payments are subject to control, account verification and payment requirements under the terms and conditions of the contribution agreements, and Sections 32, 33 and 34 of the Financial Administration Act (FAA)</i>
<i>Reporting on project results against achievement of objectives is timely and accurate.</i>
<b><i>Project Selection</i></b>
<i>Applicant's eligibility is proven and documented</i>
<i>Applicant demonstrates appropriate knowledge and capability, and support structures to undertake the project</i>
<b><i>Project Approval</i></b>
<i>Assessment criteria are defined and support program objectives</i>
<i>Project complies with program eligibility and assessment criteria</i>
<i>There is an appropriate approval or rejection of the project by a delegated authority, based upon review of the project summary form (PSF).</i>
<i>There is certification by a responsible officer that sufficient funds were available in the appropriation before the agreement was signed under Section 32 of the FAA</i>
<i>The rationale for each funding decision is appropriately documented to permit supervision and review</i>
<i>Terms and conditions in contribution agreements are consistent with the Program's Terms and Conditions and clearly outlines expected project results</i>
<i>Contribution agreements meet accountability requirements including:</i>
<ul style="list-style-type: none"> <li>▪ <i>statement of objectives;</i></li> <li>▪ <i>clear understanding between parties on required outcomes or expected results before funding begins;</i></li> <li>▪ <i>monitoring provisions based on assessment of risk; and</i></li> <li>▪ <i>conditions that must be met to receive payments.</i></li> </ul>
<b><i>Claims Verification and Approval</i></b>



<b>Audit Criteria</b>
<i>Officers have complied with financial controls including:</i> <ul style="list-style-type: none"><li>▪ <i>Section 34 – there is proof that performance conditions of the agreement were met before each payment was made</i></li><li>▪ <i>Section 33 – proof that finance officer signing was assured that Section 34 was met prior to payment authorization.</i></li></ul>
<i>Claims are reviewed for reasonableness and accuracy and are examined for compliance with terms of contribution agreements.</i>
<i>Progress reports prepared by the recipient, either on a monthly basis or in conjunction with the submission of claims, are reviewed to ensure the project is progressing consistently with the contribution agreement statement of work.</i>
<i>A mechanism exists to verify that the terms of contribution agreements have been met. Consequences for non-compliance have been defined and are adhered to in practice.</i>
<i>Monitoring and audit requirements of the program’s Risk-Based Audit Framework have been met and issues identified are resolved on a timely basis.</i>
<b>RISK MANAGEMENT</b>
<i>A mechanism exists to systematically identify, assess, monitor and report on risks facing the program.</i>
<i>A risk-based approach to the monitoring of contribution agreements exists and is followed.</i>
<b>GOVERNANCE</b>
<i>Results expected from the program are clear, measurable, and directly related to program objectives</i>
<i>Expected results are monitored and communicated on a regular basis and support management decision-making.</i>
<i>Roles and responsibilities for managing and delivering the program are well defined.</i>
<i>There is a process in place to determine whether the project was successful in contributing to expected program results.</i>
<i>SFF Program guidelines are fully consistent with the Policy on Transfer Payments.</i>



## Appendix B: Lessons Learned

It is recognized that key lessons learned from the initial SFF Program were identified and acted upon by management to improve the design and delivery of the renewed Program. Specifically, the following improvements have been made:

- The renewed Program's Terms and Conditions more clearly define eligible expenses and specifically prohibit the ability of purchasers to act as project managers;
- Recipients are required to report project performance against pre-defined criteria using qualitative information;
- Program officers are required to conduct site visits for monitoring purposes during the application, project implementation, and project completion phases; and
- Project approval decisions are documented using assessment criteria from the Project Summary Form (PSF).

Our interviews with representatives of Program management indicate that ongoing efforts are made to further improve the efficiency and effectiveness of the Program as it continues to evolve.

## Appendix C: Management Response and Action Plan

Recommendation (Page/Section)	Planned Action or Justification for no action on the Recommendation	Responsible Official	Target Completion Date	Revised Completion Date	Current Status
<p>Information in some project files was not supported by sufficient back-up documentation and/or was not in accordance with documented Program procedures.</p>	<p>We agree. We will take greater care in the completeness of file documentation.</p> <p>Going forward we will now obtain either a bill of sale or other documentation that the vessel has been acquired by the purchaser and we also obtain confirmation from the financing institution that the loan has been disbursed.</p> <p>Acknowledgement of information received letters will now be prepared and the SFF office will inform the applicant in writing when an application is deemed complete and sent through the approval process.</p>	<p>Director General, Aerospace, Defence and Marine Branch</p>	<p>In progress</p>		



Management Response and Action Plan

<b>Recommendation (Page/Section)</b>	<b>Planned Action or Justification for no action on the Recommendation</b>	<b>Responsible Official</b>	<b>Target Completion Date</b>	<b>Revised Completion Date</b>	<b>Current Status</b>
The date of receipt of a completed application under the Program is not clearly defined. This may lead to difficulties in substantiating the timing of applications in the instances where more than one project of similar merit is submitted for project funding under the same time period.	We agree. The date of completion of the applications will be included in the files in the future and communicated to the applicant.	Director General, Aerospace, Defence and Marine Branch	Completed		