



## **Farm Credit Canada**

### Special Examination Report—2012

---



Office of the Auditor General of Canada  
Bureau du vérificateur général du Canada

---

OAG-BVG

*Ce document est également publié en français.*

© Her Majesty the Queen in Right of Canada, represented by the Minister of Public Works and Government Services, 2012.





Office of the Auditor General of Canada  
Bureau du vérificateur général du Canada

To the Board of Directors of Farm Credit Canada:

We have completed the special examination of Farm Credit Canada in accordance with the plan presented to the Audit Committee of the Board of Directors on 4 October 2011. As required by Section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 15 August 2012.

I would like to take this opportunity to express my appreciation to the Board members, management, and Farm Credit Canada's staff for the excellent cooperation and assistance offered to us during the examination.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Clyde M. MacLellan".

Clyde M. MacLellan, CA  
Assistant Auditor General

OTTAWA, 31 July 2012



# Table of Contents

<b>Main Points</b>	1
<b>Special Examination Opinion</b>	5
<b>Overview of Farm Credit Canada</b>	7
<b>Focus of the special examination</b>	9
<b>Observations and Recommendations</b>	9
<b>Corporate governance</b>	9
Progress has been made in response to prior recommendations on governance, but more work is needed	10
The Board of Directors has what it needs to provide stewardship and oversight	11
Board members' skills and experience need to be better identified and used	12
The internal audit function plays a role in the Corporation's governance	14
<b>Strategic planning, performance measurement, and reporting</b>	14
The Corporation has made progress on our previous recommendations on strategic planning and performance measurement	15
Sound planning practices are in place to provide clear direction, but performance reporting needs improvement	16
<b>Enterprise risk management</b>	19
Progress has been made on our previous recommendations regarding risk management	19
The Corporation needs a more systematic and centralized approach to risk management	20
<b>Lending</b>	21
Improvement in addressing our previous recommendation regarding environmental risk assessment processes is required	22
The lending activities are managed, monitored, and reported according to policies and procedures	23
Procedures for considering the environmental effects of projects submitted for loans are not always followed	24
<b>Treasury and investment management</b>	25
Improvements have been made on our previous recommendation on risk measurement tools	26
Treasury activities support those of the Corporation, but opportunities for improvement exist	26
Venture capital policies and procedures support investment management activities	29
<b>Human resources</b>	29
The Corporation has addressed most of our previous human resource recommendations, but more reporting is required	30
The Corporation has the systems and practices to assess its human resource needs	30
Compensation reporting to the Board needs improvement	31

<b>Information technology</b>	<b>34</b>
The Corporation has addressed most of our previous IT recommendations, and detailed documentation is still in progress	<b>34</b>
Information systems support the organization	<b>35</b>
<b>Conclusion</b>	<b>37</b>
<b>About the Special Examination</b>	<b>38</b>
<b>Appendix</b>	
List of recommendations	<b>41</b>

# Farm Credit Canada

## Special Examination Report—2012

---

### Main Points

#### What we examined

Farm Credit Canada (the Corporation) is a self-sustaining Crown corporation established in 1959. It provides financial products, knowledge, and services to farming operations, including family farms, and to rural farm-related businesses. Farmers represent 87 percent of the Corporation's customers, and suppliers and processors represent 13 percent.

Investing in and supporting agriculture and the agri-food industry gives the Corporation responsibility for managing an investment portfolio of \$22.6 billion. Its loan portfolio has increased from \$13 billion in March 2007 to \$22.6 billion in March 2012.

The Corporation has over 1,500 employees and operates out of 100 offices located primarily in rural communities. It reports to Parliament through the Minister of Agriculture and Agri-Food.

We examined whether Farm Credit Canada's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. We focused on the areas of governance, strategic planning and enterprise risk management, performance measurement and reporting, lending, treasury and investment management, human resources, and information technology. Our examination work was completed on 29 February 2012. For details on the conduct of the examination, see **About the Special Examination** at the end of the report.

#### Why it's important

The Corporation operates within two major industries—agriculture and finance—both of which are shaped by global trends and market forces such as the global financial crisis, continued consolidation of the agriculture industry, climate change, and changing demographics and markets. The agriculture and agri-food industry is a major contributor to the Canadian economy, employing more than two million Canadians, with total exports worth billions of dollars annually.

**What we found**

We found no significant deficiencies in the Corporation's systems and practices. This means the Corporation maintains systems and practices that provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively. A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having that assurance.

We noted good practices in a number of areas. We also noted some areas where the Corporation would benefit from improving its practices.

- The Corporation has in place the key elements of a good governance framework. The Board has access to resources and information it needs to provide appropriate stewardship and oversight. Roles and responsibilities are clearly defined and understood, and the Board is supported by a committee structure. The process used by the Board to self-assess its performance and competencies is not currently applied at the committee level. A more thorough analysis of the competencies and skills of committees would enable Farm Credit Canada to target training and get the most benefit from its committees.
- The Corporation has clearly defined and communicated its strategic direction. Performance is measured against strategic goals and objectives, but measures are focused on tasks rather than outcomes. As a result, the performance information and progress reported annually by the Corporation does not clearly reflect how successful it has been in achieving its critical outcomes and strategic objectives.
- The Corporation has put in place processes for identifying, measuring, monitoring, and reporting on risks. Risks are identified, monitored, and managed within divisions and at the corporate level. The Corporation's lending and credit risk management activities are supported by a high-level framework and by policies and procedures that promote the achievement of the Corporation's mandate and business objectives. While the Board is informed about the various risks, the information is fragmented. The Corporation would benefit from the position of a Chief Risk Officer as it would help senior management and the Board understand the interrelationships in various types of risks.
- The Corporation's success relies heavily on the skills and knowledge of its people. A human resource management framework helps ensure that it has the human resource capacity



and work environment it needs to achieve its goals and objectives. It has developed a workforce plan and a learning strategy, and has put in place a succession plan. However, management and disclosure of its compensation framework could be improved.

- The Corporation's information technology management supports its strategic and operational objectives, ensures business continuity, and satisfies information needs in a timely manner.

***The Corporation has responded.*** *The Corporation agrees with our recommendations. Its responses follow the recommendations throughout the report.*



## Special Examination Opinion

To the Board of Directors of Farm Credit Canada

1. Under section 131 of the *Financial Administration Act*, Farm Credit Canada (the Corporation) is required to maintain financial and management control, and information systems and management practices that provide reasonable assurance that
  - its assets are safeguarded and controlled;
  - its financial, human, and physical resources are managed economically and efficiently; and
  - its operations are carried out effectively.
2. Section 138 of the Act also requires the Corporation to have a special examination of these systems and practices carried out at least once every 10 years.
3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination—from May 2011 to February 2012—there were no significant deficiencies in the Corporation’s systems and practices.
4. We based our examination plan on our survey of the Corporation’s systems and practices and a risk analysis. On 4 October 2011, we submitted the plan to the Audit Committee of the Board of Directors. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.
5. The examination plan also included the criteria that we used to examine the Corporation’s systems and practices. These criteria were selected for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in **About the Special Examination** at the end of this report.
6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the

circumstances. In carrying out the special examination, we relied on the internal audit report Farm Credit Canada BK [Business and Technology Transformation] Program Review.

7. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices.

A handwritten signature in black ink, appearing to read "Michael Ferguson".

Michael Ferguson, FCA  
Auditor General of Canada

11 May 2012  
Ottawa, Canada

## Overview of Farm Credit Canada

8. Farm Credit Canada (the Corporation, or FCC) was established in 1959 by the *Farm Credit Act* as the successor to the Canadian Farm Loan Board and is an agent Crown corporation named in Part I of Schedule III of the *Financial Administration Act*. The Corporation is wholly owned by the Government of Canada and is not subject to the requirements of the *Income Tax Act*.

9. On 2 April 1993, the *Farm Credit Corporation Act* was proclaimed into law and replaced the *Farm Credit Act* and the *Farm Syndicates Credit Act*, both of which were repealed. The Act provides for continuation of the Corporation with its corporate office in Regina, Saskatchewan, under an expanded mandate that includes broader lending and administrative powers.

10. On 14 June 2001, the *Farm Credit Canada Act* received royal assent, which updated the *Farm Credit Corporation Act*, allowing the Corporation to offer producers and agribusiness operators a broader range of services.

11. The Corporation's mandate is to "enhance rural Canada" by providing specialized and personalized business and financial services and products to farming operations. These include family farms as well as small and medium-sized businesses related to farming. Farmers represent 87 percent of the Corporation's customers, while suppliers and processors represent 13 percent.

12. Farm Credit Canada is a self-sustaining federal Crown corporation. The Corporation provides financial products, knowledge, and services to over 100,000 agricultural operations (primary producers) and agricultural businesses on the input or output side of primary production that produce, transport, store, distribute, process, or add value to agricultural commodities. These products and services include flexible financing, equity, insurance, management software, information, and learning. The Corporation provided learning events and publications to over 10,000 participants and 100,000 subscribers, respectively, in the 2009–10 fiscal year.

13. The Corporation operates out of 100 offices located primarily in rural communities and has over 1,500 employees. Investing in and supporting agriculture and the agri-food industry gives the Corporation responsibility for managing an investment portfolio of more than \$22.6 billion as of March 2012. This represents

a 74 percent increase in the loan portfolio, up from \$13 billion in March 2007. The Corporation’s financial position and forecasted growth are in Exhibit 1.

**14.** Farm Credit Canada (FCC) has experienced significant growth every year for more than a decade. Its share of the agricultural lending market has steadily increased from 23.7 percent to 27.1 percent for the same period. The Corporation attributes its growth to the total increase in loans made to primary producers in all major businesses. There has been an increase in business relationships with agricultural and financial organizations, an increase in the cost of growing crops, and improvements in customer profitability, which enables FCC clients to increase capital expenditures. FCC expects the pace of future growth to slow down due to the economy.

**15.** The Corporation’s strategy, as presented in its 2011–12 to 2015–16 Corporate Plan Summary, includes the following elements:

- financial viability and enterprise risk,
- customer experience,
- efficiency and execution, and
- employee experience.

**16.** The Corporation reports to Parliament through the Minister of Agriculture and Agri-Food. It is governed by a Board of Directors, which consists of a Chair and up to 11 voting directors who are appointed by the Governor in Council, on the recommendation of the Minister. The directors serve part-time and are paid on a per diem rate. The Corporation’s President and Chief Executive Officer and Senior Management Team oversee its day-to-day activities.

**Exhibit 1 The Corporation’s financial position and forecasted growth**

(\$ millions)	2007	2008	2009	2010	2011	2012	2013 (projected)
Total assets	13,834	15,470	17,803	20,251	21,871	23,829	23,464
Loans receivables	13,013	14,467	16,540	19,160	20,751	22,590	22,239
Total liabilities	12,372	13,694	15,519	18,039	19,189	20,721	20,204
Borrowings	12,054	13,299	15,345	17,759	18,952	20,342	19,923
Net income	204	205	212	280	460	565	379

2007 to 2009 – Information prepared according to Canadian generally accepted accounting principles  
 2010 to 2013 – Information prepared according to International Financial Reporting Standards

17. The Corporation operates in the agricultural marketplace, which is subject to volatility and adverse weather conditions that continue to create financial challenges for farmers. The agriculture and agri-food industry is more diverse and complex than ever and is a major contributor to the Canadian economy. It employs more than two million Canadians and its total exports are worth billions of dollars annually. The Corporation operates within two major industries: agriculture and finance, which are both shaped by market forces and global trends. Examples of such forces are the global financial crisis, continued consolidation of the agriculture industry, climate change, and changing demographics and markets.

### Focus of the special examination

18. Our objective is to determine whether Farm Credit Canada's systems and practices provide it with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively during the period covered by the examination. We focused on the areas of governance, strategic planning and enterprise risk management, performance measurement and reporting, lending, treasury and investment management, human resources, and information technology.

19. Further details on the audit objectives, systems and practices, and criteria are provided in **About the Special Examination** at the end of the report.

## Observations and Recommendations

### Corporate governance

20. Corporate governance is the structure, systems, and practices for overseeing the direction and management of an organization in order to carry out its mandate and achieve its objectives. Sound practices in corporate governance are essential to meeting the objectives that are outlined in Part X of the *Financial Administration Act* as it relates to Crown corporations.

21. We examined whether Farm Credit Canada (the Corporation or FCC) has a well-performing corporate governance framework that meets the expectations of best practices in board stewardship, shareholder relations, and communication with the public.

22. We looked at the following elements of the Corporation's governance framework:

- appointment and functioning of the Board and its committees,

- information for the Board's decision making and oversight,
- corporate ethics,
- external relations, and
- internal audit.

23. Overall, we found that the Corporation has the key elements of a good governance framework. However, we noted that the Board may need to further identify the competencies and skills of its directors on each committee in order to provide the Directors with training needed to fulfill their responsibilities.

**Progress has been made in response to prior recommendations on governance, but more work is needed**

24. In our previous special examination of Farm Credit Canada in 2007, we recommended that the Corporation

- ensure that its Board of Directors strengthen its oversight role by re-approving policies subsequent to significant change and ensure that policies include a description of the exception reporting processes, where required;
- clarify who is responsible for establishing and assessing the performance of the President and Chief Executive Officer;
- develop and update a skills gap analysis annually, develop training plans for Board members, and offer Board members the opportunity to learn and review the principles of risk, asset, and liability management every year;
- reconsider the responsibilities and reporting relationship of the Vice-President of Internal Audit and shift the responsibility to monitor compliance with lending policies and procedures to lending operations; and
- rotate the consultants it used for Treasury audits.

25. We found that Farm Credit Canada has addressed our recommendations on governance. While FCC updates annually its skills gap analysis and provides training opportunities to the directors, both processes could be improved (see the discussion in paragraphs 33 to 36 and our recommendations in paragraphs 37 and 38).



---

**The Board of Directors has what it needs to provide stewardship and oversight**

**26.** FCC's Board of Directors is composed of 12 members, including the Chair and the President and Chief Executive Officer. The Board is supported by three Board committees (the Corporate Governance Committee, the Audit Committee, and the Human Resources Committee). We found the Board has clearly defined its roles and responsibilities and those of its committees in their respective terms of reference. The Board reviews and approves terms of reference regularly. Each committee meets periodically and reports regularly to the Board.

**27.** The Corporation organizes an initial orientation session for new members of the Board, which informs them of the Corporation's Act and By-laws, Board and committee charters, Board governance guidelines, and Code of Conduct and Ethics. One-on-one meetings are scheduled with various vice-presidents as well as with the President and Chief Executive Officer to provide an overview of FCC's business and aspects that are relevant to directors such as treasury operations. Follow-up sessions are offered six months after the orientation session. As FCC's main operations are those of a financial institution, knowledge of financial management is required of its directors in order for them to fulfill their responsibilities.

**28.** We found that Board members have access to resources that allow them to meet their responsibilities. The Board communicates regularly with the President and Chief Executive Officer and the management of the Corporation. Directors hold part of each meeting without management in attendance; this further enhances the Board's independence.

**29.** We found that the Board

- receives credible, timely information from management in order to interpret the Corporation's legislative requirements and corporate objectives;
- provides management with strategic direction; and
- exercises its oversight responsibilities.

**30.** The Board approved a Code of Conduct and Ethics in 2005 for employees and Board members. This code is consistent with the *Conflict of Interest Act* and the 2003 Values and Ethics Code for the Public Service. The code is communicated throughout the Corporation via the intranet. New employees joining the Corporation receive training on this code and acknowledge in writing that they

have reviewed and understood it. We found that Board members and employees complete a conflict of interest declaration when they join the Corporation and renew their declaration annually. Board members proactively disclose potential conflicts of interest at Board meetings.

31. We found that the Corporation's Integrity Officer investigates disclosures of wrongdoing made by employees, and the Board is kept informed. FCC's Code of Conduct and Ethics contains a specific section on "whistleblower protection"; this section is consistent with the *Public Servants Disclosure Protection Act*.

32. The Corporation produces an Annual Report, which is available on its website, and the Board of Directors holds an annual public meeting as required by the *Financial Administration Act*. The Corporation has also developed a Government Relations Strategy, which identifies key government stakeholders and a set of actions to build and maintain strong relationships. Dialogue with key stakeholders is ongoing and open; it includes discussions around, for example, the Corporation's performance and activities, as well as operational objectives. The President and Chief Executive Officer, as well as members of management, meet with various players in the industry. FCC also has a Customer Complaints Policy, which guides the management of external complaints. FCC's website provides detailed information on how to make a complaint.

#### **Board members' skills and experience need to be better identified and used**

33. We found that the Board assesses the performance of the President and Chief Executive Officer once a year and discusses succession planning for corporate executives. The Board, as a whole, regularly conducts self-assessments of its performance and competencies. However, the competency self-assessment is not done for each committee. Such assessment would help identify ways to improve practices and identify competencies and skills required by the Board or its committees.

34. The Corporation's Board of Directors, through its Corporate Governance Committee, is responsible for preparing and maintaining a competency profile that reflects the full range of competencies, skills, and experience that future Board members will need to carry out their responsibilities. The Board profile has been completed. The Corporation's operations suggest that the Board needs expertise in at least two areas: agriculture and financial management. The latter includes knowledge related specifically to portfolio management

and profitability, credit quality, capital management, evaluation of credit risk, and assets and liability management.

**35.** We found that directors complete a competency and skills questionnaire annually. The information received from each director is tabulated to assess the Board's collective competency and skill level, as well as its overall profile. This self-assessment helps the Board assign members to specific committees and determine what skills and training activities to offer its members. This approach allows the identification of areas for improvement at the Board level; however, this exercise is not performed for each committee. In our opinion, Farm Credit Canada would benefit from conducting a more thorough analysis by committee, because this would allow the Board to better identify the areas for improvement, and to determine if each of the committees is made up of directors with the required skills and expertise to carry out their roles and responsibilities. FCC would then be better positioned to ensure that members receive relevant training and therefore maximize the functioning of the various committees.

**36.** We also found that the Board conducted most of its training activities in 2008 and 2009, and that the training was not always linked with the areas for improvement identified in individual member self-assessment. We noted that most of the training taken was in the field of corporate governance, human resource management, and risk management. Areas such as financial management, environmental management, information technology and e-business, corporate social responsibility, and law have not been addressed consistently through Board training activities.

**37. Recommendation.** Farm Credit Canada should further develop its Board self-assessment to help identify ways to improve practices, competencies, and skills that are essential for the Board and its committees.

*The Corporation's response.* Agreed. Farm Credit Canada will work with the Board to enhance the competency self-assessment process in the 2013–14 fiscal year. This will include expanding the process to the committee level with consideration given to the Board competency profile requirements.

**38. Recommendation.** Farm Credit Canada's Board of Directors should, in collaboration with Corporation management, identify opportunities for more training. FCC should provide this training to help directors fully understand the Corporation's affairs and play the Board's oversight role.

*The Corporation's response.* Agreed. Farm Credit Canada will work with the Board to implement this recommendation. Future training will be more deliberately planned and linked to the outcomes of the enhanced Board competency self-assessment process.

### **The internal audit function plays a role in the Corporation's governance**

39. The Corporation's internal audit function is an important element in corporate governance, as it provides assurance to senior managers and the Board that important financial, administrative, and operational activities are carried out efficiently and effectively.

40. The internal audit function reports directly to the Audit Committee, which reviews and approves the Internal Audit Plan. The Vice-President of Internal Audit meets regularly with the Audit Committee to report on the status of planned and current projects and on progress toward internal audit function objectives.

41. The activities of the internal audit function were reviewed in 2007. The conclusion was that the internal audit function complied with the standards of The Institute of Internal Auditors. The review identified opportunities for improvements. All of those key recommendations have been addressed by the Corporation. The internal audit function was also evaluated in 2011 to determine its level of readiness for the next review, which is scheduled in 2012.

### **Strategic planning, performance measurement, and reporting**

42. Strategic planning guides what an organization is, what it does, and why it does it, with an eye on the future. It includes assessing and adjusting the organization's direction in response to the risks it faces in a changing environment. Measuring and reporting performance are important steps in making sound decisions, holding management accountable for its use of resources, and demonstrating to Parliament and stakeholders the extent to which the Farm Credit Canada (the Corporation, or FCC) has achieved expected results under its strategic planning.

43. We examined whether the Corporation has clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandates. The Corporation's strategic direction and goals need to take into account

- government priorities,
- identified risks, and
- the need to control and protect its assets and manage its resources economically and efficiently.

We also examined whether the Corporation has identified performance indicators to measure the achievement of its mandate and statutory objectives. The Corporation's reports should provide complete, timely, and balanced information for decision making and accountability reporting.

44. In examining strategic planning, performance measurement, and reporting, we looked at the following elements:

- the Corporation's 2011–12 to 2015–16 Corporate Plan Summary and the process to develop it;
- the Corporation's assessment of its internal and external environments, as well as of its strengths, weaknesses, opportunities, and threats;
- how the strategic direction was communicated throughout the organization;
- the process to select performance indicators;
- the monitoring and reporting of performance information, including a review of internal performance reports and the Annual Report; and
- public reporting of performance information.

45. Overall, we found that the Corporation has clearly defined and communicated its strategic direction in its 2011–12 to 2015–16 Corporate Plan Summary. Strategic direction considers the operating environment, the corporate risks it faces, and the organizational strengths and weaknesses. In addition, we found that the Corporation produces performance information that enables the Board of Directors and stakeholders to assess its performance, as well as its progress toward the achievement of its mandate, statutory objectives, and key strategic objectives. However, we found that, while the Corporation measures its performance related to its strategic goals and objectives, the measures are focused on tasks rather than outcomes.

**The Corporation has made progress on our previous recommendations on strategic planning and performance measurement**

46. In our previous special examination of Farm Credit Canada in 2007, we recommended that the Corporation

- ensure that its divisional business plans share a common format to provide better accountability and reporting, have a formal approval process, and contain a link to Vice-President performance objectives;

- continue to refine its corporate measures and develop targets for identified performance measures, to provide a better explanation of negative results, and to include the impact that identified risks could have on the Corporation's ability to achieve its objectives; and
- work toward greater disclosure and transparency in its external reporting to more fully elaborate on its public policy role in its Annual Report, taking into consideration its credit risk.

47. We found that Farm Credit Canada has addressed our recommendations on strategic planning and performance measurement.

**Sound planning practices are in place to provide clear direction, but performance reporting needs improvement**

48. We found that the Board of Directors approves the Corporation's strategic direction and is involved in the planning process. In developing its strategic plan, FCC considers

- its external and internal operating environment,
- its most recent risk assessment, and
- an assessment of its strengths and weaknesses as well as its client needs.

49. The Corporation has defined its mission, vision, and critical outcomes for the long term. It has also outlined its corporate objectives for the planning period. Each objective is supported by specific initiatives to achieve them. To assess performance on its objectives, the Corporation has developed a set of performance measures and targets to assess performance. We found that the 2011–12 to 2015–16 Corporate Plan Summary was aligned with, and supported the execution of, the Corporation's mandate, as set out in the *Farm Credit Canada Act*. The Corporation's Corporate Plan Summary was approved by the Board and by the Governor in Council on the recommendation of the Minister of Finance on a timely basis.

50. Each year, the Corporation's divisions develop operational plans that reflect corporate objectives and further identify initiatives to support objectives. These plans contain sufficient detail to assist management in assigning responsibilities and allocating corporate resources by priority. We found that the divisional initiatives are linked to the corporate strategic initiatives or support operations. The Strategy and Risk Management Business Unit reviews the overall

results of all the division plans to ensure that plans reflect an economic and efficient use of the Corporation's resources.

**51.** All elements of the corporate strategy, which includes all corporate measures, initiatives, and risks, are reported quarterly within the corporate scorecard provided to the Executive Management Team and the Board. This scorecard, along with the Corporation's Annual Report, provides credible, timely, and balanced information for decision making and reporting.

**52.** We found that the Corporation communicates its Corporate Plan Summary in a timely manner throughout the organization using various means, including meetings with managers and communications through the Corporation's intranet site. In addition, strategic objectives are incorporated in individual performance objectives and translated into specific tasks, which are monitored as part of the annual performance review, to ensure behaviours throughout the organization align with the strategic plans.

**53.** In its Corporate Plan Summary, the Corporation establishes critical outcomes with a long-term vision for each of its strategic themes. It develops medium-term strategic objectives that support these outcomes, as well as initiatives to achieve these objectives. The Corporate Plan Summary also includes the performance measures and targets that FCC has developed. The progress measured on its objectives is reported to the public in FCC's Annual Report.

**54.** In its Corporate Plan Summary, FCC reports initiatives under specific strategic objectives. However, it does not explain to readers how the measures are logically linked to those strategic objectives. It also does not make clear the connection between the strategic objective and the critical outcome. Exhibit 2 presents an excerpt from the Corporate Plan Summary regarding one of its strategic themes: customer experience. For example, it would be difficult for a reader to make the link between the initiative "enhance venture capital offering" listed in Exhibit 2 with the strategic objective and the critical outcome. The information provided does not present a coherent story whereby a reader could assess the Corporation's performance.

**Exhibit 2 The Corporate Plan Summary does not make the link clear between initiatives, objectives, and outcomes**

**Strategic theme: Customer experience**

**Critical outcome:** In 2020, FCC continues to deliver an extraordinary experience to customers. The Customer Experience Index score indicates that two out of three customers (65 percent) rate their experience with FCC as five out of five.

Five-year strategic objectives 2011–16	Measures	2011–12 initiatives
Demonstrate commitment to the agriculture and agri-food industry, with a particular focus on producers and young farmers	Total lending to young farmers Number of learning program participants	<ul style="list-style-type: none"> <li>• enhance programs to support young farmers</li> <li>• implement knowledge offering that adds value to customers</li> <li>• increase collaboration with Agriculture and Agri-Food Canada on key issues impacting sector</li> <li>• enhance venture capital offering</li> </ul>

Source: Corporate Plan Summary 2011–12 to 2015–16

55. FCC also reports on its performance measures and progress in its Annual Report. However, the information it presents there also does not fully enable an assessment of its success in the achievement of its critical outcomes and its strategic objectives. The information in the Annual Report focuses on the execution of tasks, such as lending to young farmers, rather than on measures of success related to its critical outcome or its strategic objectives. Monitoring and measuring outcomes, in addition to currently tracking the achievement of underlying initiatives, is necessary in order to measure success against critical outcomes and strategic objectives.

56. **Recommendation.** Farm Credit Canada should assess its performance in achieving critical outcomes and strategic objectives.

*The Corporation's response.* Agreed. Farm Credit Canada will undertake a comprehensive review of critical outcomes and strategic objectives in the 2012–13 fiscal year planning cycle and expand its performance measures to be more outcome-oriented.



**Enterprise risk management**

57. Enterprise risk management promotes a systematic approach to managing risk, applies sound risk management practices, and fosters a culture where learning, innovation, responsible risk taking, and continuous improvement are valued. In a period of growth such as the one that Farm Credit Canada has experienced, managing risks is key.

58. We examined whether the Corporation has addressed risk in its corporate culture, and whether it has done so at all levels of the Corporation and has supported the realization of its mandate, business goals, and objectives. We examined whether the risk was identified, measured, mitigated, monitored, and reported to stay within a level appropriate to the nature of the business.

59. We looked at the enterprise risk management process, including the following elements:

- the Corporation's enterprise risk management framework and policies;
- implementation of these policies around risk measurement, mitigation, and monitoring; and
- risk management reporting throughout the organization.

We discuss the management of credit risk in more detail in the section on Lending, in paragraphs 77 to 82.

60. Overall, we found that the Corporation has an enterprise risk management framework that is supported by a risk culture and processes that promote the achievement of its mandate and business objectives. However, we found that FCC could further enhance its enterprise risk management by creating a Chief Risk Officer position.

**Progress has been made on our previous recommendations regarding risk management**

61. In our previous special examination in 2007, we recommended that FCC extend its approach to integrated risk management, emphasizing operational risks and, in particular, risks to its reputation as a Crown corporation. We recommended that the Corporation link its risk assessment process closely with its strategic and operational planning processes. We also recommended that FCC focus on further implementing and monitoring the effectiveness of the various action plans.

62. We found that Farm Credit Canada has addressed our recommendations on enterprise risk management.

**The Corporation needs a more systematic and centralized approach to risk management**

**63.** The Corporation has continued to enhance its Enterprise Risk Management Framework, which has been approved by the Board of Directors. We found that the framework

- defines the purpose of the enterprise risk management function,
- states the governing principles,
- identifies the components of the methodology for managing risk, and
- defines roles and responsibilities.

**64.** FCC's Enterprise Risk Management Steering Committee, which is led by the Senior Vice-President of Strategy, Knowledge and Reputation, ensures that FCC's overall risk assessment complies with the framework. There is a constant effort to integrate risk management into the Corporation's strategic planning.

**65.** We found that by implementing the framework, the Corporation has put in place processes for identifying, measuring, monitoring, and reporting on risks. We noted that the risk identification process starts with business planning at each division. It is enhanced by various initiatives, resulting in the development of a Corporate Risk Register. Identified risks are categorized (credit, market, operational, strategic, and reputational) and developed in consultation with the relevant management committees and the Executive Management Team in an annual process that determines the Corporation's top risks.

**66.** For these top risks, a detailed action plan is developed by a member of the senior leadership team who is assigned as the risk sponsor for its corresponding area. We found that the risk sponsor identifies the controls and oversight that exist or that need to be put in place to manage each top risk. The top risks identified are monitored and reported on quarterly through the corporate scorecard, which is presented to the Board's Corporate Governance Committee.

**67.** While the framework and associated risk management activities help the Corporation define its approach to risk management, there is a lack of comprehensive documented procedures for individuals to follow. Specifically, there is no direction provided on the nature and extent of work required to fulfill risk management responsibilities and identify escalating risk. We noted that risk management activities

at operational levels are not evaluated for effectiveness or compared for consistency by a central authority, aside from those activities related to top risks.

**68.** We also found that FCC has not yet developed a policy to articulate its risk tolerance. The various types of risks that the Corporation takes on are managed separately by divisions or committees responsible for them, under various guidelines and policies. For example, the monitoring of credit risk is done through the Board's Audit Committee, and risks related to human resources are reported through its Human Resources Committee. While Board meetings may include a summary of committee discussions about risk and a review of the corporate scorecard, the management and reporting of risks is fragmented throughout the organization.

**69.** Currently, Chief Risk Officer positions are becoming more common in the industry to oversee organizations' risk management practices. Having a single executive responsible for risk management makes sense for the effective management of corporations in the same way as having a single Chief Executive Officer or Chief Financial Officer. While in the past, it may have been the practice for a risk management officer to provide technical input to the decisions of an organization's policy makers, today, the Chief Risk Officer of leading companies, such as financial institutions, participates in policy making and decision making. A Chief Risk Officer helps senior management and the Board understand the interrelationships of various types of risk. With that understanding, management can relate decisions on the risks it takes to decisions on the capital resources used, in order to derive real value to the organization.

**70. Recommendation.** Farm Credit Canada should extend its approach to integrated risk management through the creation of a position of Chief Risk Officer.

*The Corporation's response.* Agreed. Farm Credit Canada will pursue the creation of a Chief Risk Officer position in the 2013–14 fiscal year.

## Lending

**Credit risk**—The risk of financial loss resulting from the failure of debtors to honour their financial or contractual obligations in full. Sound credit risk management involves prudently managing and controlling credit risks across a variety of dimensions, such as quality, concentration, currency, maturity, security, and type of credit facility.

**71.** Lending, and the management of related **credit risk**, is core to Farm Credit Canada's (the Corporation, or FCC) operations. The nature of the Corporation's activities exposes it to significant financial risks, particularly the credit risk of its customers. As a result, to meet its statutory mandate, the Corporation must have systems and practices for lending and managing credit risk. These systems and practices need to enable the Corporation to review and monitor issued loans and their pricing to ensure it is meeting the needs of its key

customers. Improvements can then be made, if required, to achieve the Corporation's profitability and credit risk objectives.

72. We examined whether the Corporation has defined policies, procedures, and controls for portfolio management and pricing. We examined whether the Corporation

- has identified credit risk problems,
- estimates credit impairment in the portfolio, and
- regularly monitors and reports on the overall credit risk of the portfolio.

We also examined whether the Corporation has considered environmental and sustainable development when it makes lending decisions and manages its portfolio.

73. We looked at the following elements:

- loan portfolio risk management,
- pricing of products,
- loan initiation and approval,
- loan operational review,
- specific and general allowance processes, and
- application of the *Canadian Environmental Assessment Act*.

74. Overall, we found that the Corporation's lending and credit risk management activities are supported by a framework, as well as policies and procedures. The Corporation estimates its credit impairment in the portfolio. The compliance monitoring to ensure adherence to its policy to manage environmental risk is not yet systematically implemented.

**Improvement in addressing our previous recommendation regarding environmental risk assessment processes is required**

75. In our previous special examination in 2007, we recommended that Farm Credit Canada

- review its risk scoring and pricing system (which estimates credit losses and establishes product pricing) and update the internal data as planned;
- provide guidance and training to relationship managers so they can better analyze and support decisions about environmental effects and improve the forms and the documentation about the

decisions related to the *Canadian Environmental Assessment Act*; and

- consider tailoring its assessment process for the Act to reflect the environmental risks associated with proposed projects that may be supported by FCC, rather than treating all projects the same.

**76.** We found that Farm Credit Canada has addressed our recommendations on lending. However, the Corporation needs to better apply procedures for considering the environmental effects of projects submitted for loans (see the discussion in paragraphs 83 to 85 and our recommendation in paragraph 86).

#### **The lending activities are managed, monitored, and reported according to policies and procedures**

**77.** Farm Credit Canada has a high-level framework (the Portfolio Vision Framework) for its core business: lending. The framework states the Corporation's vision and outlines the tools for achieving it. The framework includes the Corporation's tolerance for credit risk, loan portfolio goals and objectives, and the portfolio diversification plan, all of which are based on credit quality, profitability, and growth. We found that the framework is approved annually by the Board of Directors. The Corporation also has more detailed lending and credit policies and procedures that support its lending operations. These detailed lending and credit policies and procedures are easily accessible and available to all employees. The content is structured as an interconnected suite of information, including descriptive overviews, policies, processes, procedures, authorities, forms, templates, and resources. Detailed lending and credit policies are drafted by the Portfolio and Credit Risk Division and are submitted to FCC's Credit Policy Committee for approval.

**78.** We found that the responsibility for the Corporation's credit risk management lies with the Portfolio and Credit Risk Division. The Valuations Department and the Credit and Special Credit Department are responsible for managing credit risk at the transactional (loan) level. The Portfolio Analysis and Modelling Department is responsible for managing credit risk at the overall portfolio level.

**79.** The Corporation identifies and measures credit risk using risk-scoring tools and models that estimate the credit losses. The Corporation has established a framework for validating the models and also regularly reviews the factors and information involved in estimating its credit risk, known as the allowance for loan and lease loss. When testing against historical data, the model was improved due

to the additional information on the probability that a client would default on a loan, adjustments in the business cycle, factors leading to potential losses, and changes in the terms of a loan.

**80.** The risk-scoring and pricing system provides a consistent approach to risk scoring and pricing across the Corporation. To establish competitive lending interest rates, the pricing system incorporates the internal transfer price, the market lending rates, the credit riskiness of clients, and the organization's policies regarding premiums or discounts and service fees.

**81.** We found that FCC's Portfolio Analysis and Modelling Department prepares extensive monthly reports on the current industry environment and on loan portfolio metrics such as principal balance owing on loans, weighted-average risk score, the percentage of loans for which FCC holds security, and various elements of the portfolio where the projected recovery rate is less than 100 percent. The information is reported to FCC's Asset Liability Committee for review and forms the basis for credit risk monitoring of the portfolio. Quarterly portfolio reports are provided to the Board's Audit Committee; these reports present the overall credit assessment of the portfolio, as well as the risk per region and industry sector. The quarterly portfolio reports also contain information on the portfolio diversification and concentration level compared with the limits.

**82.** We found that the compliance with lending policies and procedures is supported by the Corporation's internal control environment, as described in the Operational Risk and Control Framework. FCC monitors and reports on compliance with lending and credit policies through operational account reviews, functional and field audit reports, and loan quality reviews. The monitoring activities are performed both within and outside the Operations Division.

**Procedures for considering the environmental effects of projects submitted for loans are not always followed**

**83.** Farm Credit Canada, as a federal Crown corporation, is a responsible authority under the *Canadian Environmental Assessment Act* and must complete an assessment of environmental effects on projects carried out for its own purposes, or for projects carried out with the assistance of an FCC loan.

**84.** We found that the Corporation has in place an Environmental Risk Management Policy and other tools to help it assess risks related to the environmental effects of projects funded by FCC and whether these projects comply with the Act. These elements are designed to

allow FCC to screen each project that it may finance to evaluate its environmental impact.

**85.** We found that Farm Credit Canada does not yet have a formalized procedure in place to periodically assess and monitor the application of its Environmental Risk Management Policy and therefore compliance with the Act. At the time of our audit, the Corporation's Portfolio and Credit Risk Division had just completed a quality review of lending files to assess whether they complied with FCC's policy. Results confirmed that internal procedures were not always followed, as some assessment forms were not completed or were completed incorrectly. In December 2011, the Internal Audit Division reported similar results in its audit on the subject: inaccurate environmental information and incomplete or missing assessment forms. Internal Audit recommended regular reporting on the Corporation's compliance with the Act to senior management and the Board of Directors. (The results of the Portfolio and Credit Risk Division's review were shared only with management and not with the Board.)

**86. Recommendation.** Farm Credit Canada should develop a strategy and action plan for ensuring compliance with its Environmental Risk Management Policy.

*The Corporation's response.* Agreed. Farm Credit Canada is committed to address remaining knowledge and compliance gaps through execution of a detailed strategy and action plan commencing in the 2012–13 fiscal year.

## Treasury and investment management

**87.** Farm Credit Canada's (the Corporation, or FCC) Treasury Division is responsible mainly for managing the timely availability of cash funds to support its lending activities, and managing risk in its treasury operations.

**88.** We examined whether the Corporation has treasury strategies and programs for funding, investment, and risk management consistent with corporate objectives and risk tolerances. We examined whether the Corporation has identified, quantified, and managed risk exposures. We also examined whether the Corporation monitors and reports treasury transactions and activities to management and to the Board, at levels appropriate to these exposures. Finally, we examined whether venture capital investment activities permitted the Corporation to select its initial investments according to strategic objectives, to monitor existing investments to maximize the best time to sell the investments, and to meet the planned risk and profitability of these investments.

89. We looked at the treasury risk activities based on the analysis of the organization, objectives, and control structure of the following areas:

- funding and liquidity management,
- treasury investments (excluding venture capital),
- investments in venture capital, and
- assets and liabilities management.

90. Overall, we found that the Corporation has implemented treasury strategies and programs that are consistent with the corporation's objectives and the risks identified in individual policies, although as previously mentioned in paragraph 68, Farm Credit Canada does not have an overall risk tolerance policy. The Corporation identifies, quantifies, and manages its risk exposure, although improvements could be made. There is regular monitoring and reporting by management to the Board. Venture capital investment activities are managed through an outsourced agreement that determines the objectives, monitoring, and reporting.

**Improvements have been made on our previous recommendation on risk measurement tools**

91. In our previous examination in 2007, we recommended that FCC consider augmenting its risk measurement tools to keep up with the size and complexity of its asset portfolio. We also reported on the venture capital practices (see paragraphs 100 and 101). The Corporation has addressed our recommendations.

**Treasury activities support those of the Corporation, but opportunities for improvement exist**

92. FCC's Treasury Division is governed by a set of Board-approved policies that cover the following areas of its activities:

- funding,
- interest rate risk management,
- liquidity and investments,
- derivatives and counterparty credit risk, and
- funds transfer pricing.



93. The policies contain limits on various aspects of treasury activities. However, as previously mentioned, Farm Credit Canada has not developed a risk tolerance policy to serve as a guideline for other policies.

94. The Corporation's capital consists of allowance for credit losses, contributed surplus, retained earnings, and accumulated other comprehensive income. (Its level of capitalization is shown in Exhibit 3.) FCC's objectives when managing capital are

- to generate a sufficient rate of return from operations to remain financially self-sustaining and to fund growth and strategic initiatives;
- to have the capacity to withstand market fluctuations intrinsic to the agriculture industry while continuing to support its customers through all economic cycles; and
- to comply with the requirement imposed by the *Farm Credit Act* that restricts the total direct and contingent liabilities of the Corporation to 12 times its equity. This limit can be increased to 15 times its equity with the prior approval of the Governor in Council.

**Exhibit 3 The Corporation's level of capitalization**

(\$ millions)	31 March 2010	31 March 2011	31 March 2012
Total capitalization	2,956	3,337	3,730
Gross assets (Assets plus allowances for credit losses)	20,897	22,526	24,451
Capitalization as a percentage of gross assets	14.14%	14.81%	15.26%

2010—Information prepared according to Canadian generally accepted accounting principles  
 2011–2012—Information prepared according to International Financial Reporting Standards  
 Source: Farm Credit Canada annual reports

95. There is no explicit capital management function within the Treasury Division, although it is part of the Asset and Liability Committee's mandate. In our opinion, establishing a capital management policy would bring guidelines, systems, and practices to the Corporation and would help guide the determination of the capitalization level (the amounts described in paragraph 94) it requires to ensure that it can meet its objectives. The Corporation currently manages capital through industry-accepted measures, including measuring the credit element of capital. We also found that Farm

Credit Canada at present determines if it can meet its capital management objectives using a measure called debt-to-equity ratio, which is the level of debt expressed as dollars of debt per one dollar of total equity. While the Corporation has an established limit on its debt-to-equity ratio, it needs to implement a more comprehensive management of its capital as well as the measurement methodology for the required capital in order to have a complete understanding of its capital adequacy.

**96.** As of 21 April 2008, the Corporation must borrow money under the terms of the Crown borrowing agreement with the Department of Finance Canada to fund its activities. The agreement establishes the Corporation's cost of borrowing. The Corporation continues to carry debt raised in the capital market for borrowings prior to 21 April 2008.

**97.** We found that Farm Credit Canada determines its borrowing limits and terms in the Corporation's annual borrowing plan, which is authorized annually by the Minister of Finance. We found that the vast majority of the borrowing need is directed toward retiring the maturing debt, replacing the existing debt, or funding the portfolio growth. Farm Credit Canada measures interest rate risk through sensitivity analysis on the impact on the net interest income and through the market value of the portfolio equity.

**98.** For the first measure, the Corporation would extrapolate what the net interest income would be if the interest rate were to increase or decrease by 2 percent. The extrapolated net interest income would be compared with the limits set in the policies. The market value of the portfolio equity measure calculates the net present value of assets and liabilities. These are widely used measures of sensitivities to interest rates in the industry. Even in the absence of an overall tolerance policy, the Board approved limits around these measures that are regularly monitored and reported both to management and the Board. There are also operational limits that are set lower than those of the Board.

**99. Recommendation.** Farm Credit Canada should develop a capital management policy and should set up the necessary systems and processes to manage this policy.

*The Corporation's response.* Agreed. A formal Capital Management Framework project is currently under way to further enhance FCC's capital management practices.

### **Venture capital policies and procedures support investment management activities**

**100.** Farm Credit Canada has invested in food and agricultural enterprises using venture capital structures since 2001, when the legislation was revised to include such investment vehicles. In 2006, Farm Credit Canada outsourced the management of its venture capital portfolio whereby any future venture capital investment would be completed through a limited partnership, called the Avrio Ventures. This agreement was for a level of \$50 million.

**101.** In 2011, having reached the total investment limit in the original fund, the Corporation expanded its venture capital investment through a second limited partnership, as Avrio Ventures created a second fund. We found that before making this investment, the Corporation exercised due diligence by

- implementing investment management processes and procedures that were aligned with its objectives and that support the creation of a second fund;
- assessing the performance of the first fund; and
- identifying, measuring, and mitigating credit risks, and monitoring and reporting on investment activities and performance.

Throughout the due diligence process, management informed the Board of the developments. The Board approved the arrangement to invest an additional \$50 million.

### **Human resources**

**102.** Farm Credit Canada's (the Corporation, or FCC) success depends largely on its people. The Corporation needs the right talent and knowledge to deliver effective support for the agriculture industry. Operating in an environment that requires specific skills and that has an aging workforce, the Corporation must attract, develop, and retain employees who can help the organization meet its goals.

**103.** We examined whether human resources are managed in a manner that provides the Corporation with the human resource capacity and the work environment needed to achieve its goals and objectives.

**104.** We looked at the following elements:

- human resource planning and forecasting;
- recruitment, retention, and succession planning;
- compensation;

- training and development processes; and
- communication with employees.

105. Overall, we found that the Corporation has a human resource management framework in place that provides the Corporation with assurance that it has the human resource capacity and work environment it needs to achieve its goals and objectives. However, its management and disclosure of its total cash compensation policy could be improved.

**The Corporation has addressed most of our previous human resource recommendations, but more reporting is required**

106. In our previous special examination of Farm Credit Canada in 2007, we recommended that FCC

- have a staffing plan or strategy to proactively address future staffing needs as well as a succession management program for all major positions,
- clarify the duties of the Board's Human Resources Committee with respect to reviewing and approving the workforce plan,
- develop a training plan or strategy that addresses the training implications of its programs and initiatives that support the attainment of corporate objectives and priorities, and
- include more documentation and details on the extent of any current or potential variance with individual total cash compensation at target to support recommendations to the Board for approval of changes to salary rates and bonuses as well as approval of the Corporate Reward for employees.

107. We found that the Corporation has addressed our recommendations. However, we found that the Corporation presents annually part of its compensation target to the Board for approval, but further information should be presented and approved by the Board as well as made public (see the discussion in paragraphs 112 to 117 and our recommendations in paragraphs 118 and 119).

**The Corporation has the systems and practices to assess its human resource needs**

108. We found that the Corporation develops an overall Corporate Workforce Plan aligned with its Corporate Plan Summary. The Corporate Workforce Plan summarizes the issues and opportunities identified in all divisional workforce plans. Divisional workforce plans are developed using the workforce planning guide, ensuring

consistency in the analysis across the organization. These divisional plans include the identification and analysis of current and future business needs, as well as qualitative and quantitative data about the demographics, qualifications, competencies, and number of positions required to deliver on the future business strategy. Initiatives are developed and implemented to fill the identified human resource gaps. Management and the Board are regularly informed and updated on challenges related to human resource planning issues.

**109.** The Corporation uses succession planning to determine its future needs, and to identify high-potential staff to meet the organization's long-term needs. Farm Credit Canada has identified key leadership senior positions, identified potential successors, and prepared gradual transitions. We found that the workforce planning exercise also identifies high-potential employees to replace employees at key and critical positions at the division level, where the preparation of a formal replacement plan is required.

**110.** We found that Farm Credit Canada offers all its employees training that enables them to acquire, maintain, and develop their skills and competencies. In 2008, FCC developed a Learning Strategy that aimed to create the system and structure for choosing learning practices.

**111.** FCC employees' training needs are determined in two ways. First, employees complete an individual development plan that is aligned with the corporate strategic objectives. The monitoring of individual training is left to the employee and the supervisor. Second, the Corporation analyzes the aggregate information contained in all individual development plans to identify overall trends in employees' training needs in a more comprehensive way. This new information will contribute to implementing new initiatives to enhance the skills and competencies of FCC employees.

#### **Compensation reporting to the Board needs improvement**

**112.** The objectives, principles, and purpose of FCC's performance compensation policy are clearly stated, easily accessible, and communicated to FCC employees. The policy guides the employee through the entire compensation process, which includes

- an annual review of the external market of similar organizations to ensure that FCC salaries remain competitive,
- setting of team and individual objectives,
- identification of competencies needed,

- annual performance review, and
- potential base salary increases and team and individual pay-at-risk amounts (where employees risk not getting the pay-at-risk amount if they do not meet certain performance standards).

**113.** We found that FCC’s compensation philosophy is for total cash compensation to be paid to individuals at the 65th percentile of the marketplace. Once a year, FCC conducts a market review analysis using a comparative group of 29 organizations. The group includes some chartered banks and credit unions, as well as some other Crown corporations. We found that the exercise leads to the annual approval by the Board of a base salary for each of the 16 salary grades as well as the pay-at-risk percentage per grade. An employee needs to meet all his or her annual objectives to earn the full pay-at-risk amount.

**114.** In addition, an annual performance review leads to a rating on each employee’s performance. This rating determines any additional performance compensation an employee could earn and consists of a percentage applicable on the pay-at-risk amount. For example, if the pay-at-risk amount is 8.5 percent, and the performance component is 50 percent of the pay-at-risk amount (an additional 4.25 percent), the employee will receive an additional 12.75 percent compensation of the base salary. The additional performance compensation will never exceed the amount earned as pay at risk. On average, the performance component was 13 percent in the 2010–11 fiscal year. The total salary of an FCC employee is the sum of these three components: market-determined base salary, pay-at-risk percentage, and performance component (Exhibit 4).

**Exhibit 4 Employee compensation consists of three elements (as shown for the grade 10 pay level for the 2010–11 fiscal year)**

Base salary (A)	Pay-at-risk percentage (B)	Performance component (percentage of pay-at-risk amount) (C)	Total compensation (A + B + C)
\$71,810	8.5% (\$6,104 additional)	0% (\$0 additional pay)	\$77,914
\$71,810	8.5% (\$6,104 additional)	50% (an additional 4.25% of base salary, or \$3,052)	\$80,966
\$71,810	8.5% (\$6,104 additional)	100% (an additional 8.5% of base salary, or \$6,104)	\$84,018

**115.** We found that the base salary increments and the performance component for each individual are approved by the manager and the Vice-President of the division. The report that highlights overall compensation results and identifies the total amount to be paid for performance component and base salary increases is approved by the Executive Management Team.

**116.** We found that the performance component of Farm Credit Canada's total cash compensation policy was last discussed at a Board meeting in 2008 but was not approved by the Board. While the compensation policy may not have changed since, the members of the Board have. We found that when the Board approves the salary grades, there is no analysis of the total compensation envelope to be paid to all employees. Such information is part of the Corporate Plan Summary discussions and presentations. We also found that the Board was not told whether FCC total cash compensation met the 65th percentile of the marketplace, or whether it was over or under that target. In addition, the Board was not told whether the total compensation envelope was respected. The Board was simply provided with the total amount of compensation paid to executive members.

**117.** Farm Credit Canada operates in a competitive market where organizations in the same business provide increased public disclosure. As a federal Crown corporation in this environment, it is reasonable, in our opinion, for the Corporation to have the same level of disclosure regarding its compensation framework. Greater disclosure of the compensation framework provides readers of its Annual Report with more detailed information regarding the process taken by management in setting remuneration for its employees and the results of that process.

**118. Recommendation.** Farm Credit Canada should include for Board approval all elements of its total cash compensation (base salary, pay-at-risk percentage, and performance component) and the total compensation envelope. The Board should also be informed of the final compensation results compared with the approved envelope. All exceptions to the policy should be reported to, and approved by, the Board.

*The Corporation's response.* Agreed. Farm Credit Canada will, in the 2012–13 fiscal year, review its Board disclosure of total cash compensation to ensure completeness and transparency.

**119. Recommendation.** Farm Credit Canada should consider improving the disclosure of its compensation framework in its Annual Report.

*The Corporation's response.* Agreed. Farm Credit Canada is committed to continuously improving disclosure and transparency in external reporting. A review of compensation-related Annual Report content will be conducted relative to industry peers and best practices by 31 March 2013.

## Information technology

**120.** Information technology (IT) supports virtually all business operations. Like leaders in any organization, Farm Credit Canada's (the Corporation, or FCC) management needs accurate, timely, and complete information to manage its activities.

**121.** We examined whether the planning, development, implementation, and management of information technology and information management systems support the Corporation's strategic and operational objectives, ensure business continuity, and satisfy information needs on a timely basis.

**122.** We looked at the following elements:

- IT strategic planning and operational planning process and practices,
- IT project management practices and project management office methodology,
- information security processes,
- service-level management processes, and
- disaster response and business continuity.

**123.** Overall, we found that the Corporation's information technology management supports its strategic and operational objectives, ensures business continuity, and satisfies information needs on a timely basis.

### **The Corporation has addressed most of our previous IT recommendations, and detailed documentation is still in progress**

**124.** In our previous special examination of Farm Credit Canada in 2007, we made the following recommendations:

- As each component of the Business and Technology Transformation Program (known as BK) system is designed, project governance should continue to ensure that the related costs can be justified by the expected benefits to be derived. All



expected benefits generated by the BK Program should be clearly identified and monitored to ensure that the benefits are realized.

- The Corporation should approve and implement a clear mitigation strategy and action plan to address capacity and project management concerns identified in studies.
- The Corporation should finalize the project management action plan and clearly indicate what level of project management maturity it wants to achieve over both the short term and long term.
- The Corporation should develop an overall Corporate Security Policy from which other, more specific policies and practices can be put in place, such as the IT security policy.
- The Corporate Security Function should be placed more strategically within the organization.

**125.** We found that Farm Credit Canada has addressed our recommendations on the management of information technology projects. We found that the Corporation has recently approved an Enterprise Security Policy and is still working on finalizing the supporting detailed policies. Most of the IT security policies that support the recently approved Enterprise Security Policy are still not in place (see paragraph 132) and the Corporate Security Function is now under the responsibility of the Information Technology Division.

#### **Information systems support the organization**

**126.** The Corporation has completed an Information Technology Divisional Plan according to requirements set by the Strategy, Knowledge and Reputation Division. IT divisional objectives have been linked to corporate initiatives, strategic objectives, and themes. In order to gain a better understanding of the demands of other FCC divisions, business platform plans are in place. We found, however, that there is no comprehensive current three- to five-year information technology strategic plan that discusses the division's vision, risks, performance indicators, and needed resources. Multiple documents cover many of these components, but there is no comprehensive, complete plan.

**127.** The IT Division recognized that there were gaps in its divisional planning process and hired external consultants in 2010 and 2011 to perform reviews. These reviews identified areas for improvement that were in line with our findings. As a result, the IT Division has committed to improving its strategic planning process while still

fulfilling the reporting needs of the Strategy, Knowledge and Reputation Division. The current plan is to have the new strategic planning process in place for the 2013–14 fiscal year.

**128. Project Management.** Farm Credit Canada has reorganized and made improvements to the Project Portfolio Management process several times and has made improvements to its practices, resulting in the creation of the Enterprise Project Management Office in October 2011. The Corporation has implemented a project cycle with seven phases. This project cycle incorporates many project management best practices, including an approval process whereby all projects must pass each phase of approval in order to advance to the next phase. For projects involving IT, we found that both the Information Technology Division and business owners sign off at each phase of the project. FCC is currently assessing the benefits of having improved its project management processes. We selected the Corporation's Business and Technology Transformation Program (BK Program) to assess how well its project management practices were being applied. The BK Program dates back to 2004 and consists of four key technology projects designed to integrate the Corporation's systems and processes.

**129.** We found that there is a good IT governance framework in place to manage the BK Program. There are two main committees: the BK Program Executive Committee, which is composed of members of Farm Credit Canada's executive, and the BK Program Operating Committee, which is composed of project sponsors who meet regularly to oversee the BK Program. As well, senior BK management has not changed since the inception of the project, which has ensured good continuity.

**130.** The major changes to the BK Program have been well documented and discussed at senior levels, including the Board, so all parties understand the implications. Currently, the last release of the BK Program is scheduled to be completed by the fall of 2012. Changes in business planning have been justified and approved. The financial elements of the business case have been updated at each major decision point. In addition, a Change Management Committee has engaged management from other divisions in the decision-making and preparedness activities for the new releases.

**131.** Finally, we found that there are processes to identify, assess, assign, and monitor current, anticipated, and emerging risks for the BK Program. A risk management process is in place at both the program

and project level. At both levels, risks are identified, assessed, and tracked regularly via a risk log.

**132. Security Management.** The need to maintain the integrity of information and protect IT assets requires a security management process. This process includes establishing and maintaining IT security roles and responsibilities, policies, standards, and procedures. Security management also includes performing security monitoring and periodic testing and implementing corrective actions for identified security weaknesses. Farm Credit Canada has recently approved an Enterprise Security Policy. This policy aims to protect the Corporation's assets, which include employees, facilities, corporate information, reputation, hardware, and software. This broad policy is supported through a number of more detailed policies. The majority of these policies are still in development. We encourage the Corporation to finalize all supporting policies.

**133.** Security awareness enables an organization to sensitize its employees on issues of security and to regularly send reminders to minimize the risk related to security incidents. We found that Farm Credit Canada has security awareness materials that are available to staff. However, a formal security awareness program has not yet been implemented. The Corporation has recognized that this is an important issue, and it is currently working on a security awareness program to educate staff and to manage the risks.

## Conclusion

**134.** Based on the work performed in the special examination of Farm Credit Canada's systems and practices, we conclude that there is reasonable assurance that the Corporation has maintained systems and practices to provide it with reasonable assurance that

- its assets are safeguarded and controlled,
- its resources are managed economically and efficiently, and
- its operations are carried out effectively.

## About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

### Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every 10 years. The statutory deadline for completing and reporting this examination is September 2017. In consultation with the audit committee and management, it was resolved that a special examination be conducted and reported in 2012. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the Auditor General provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 5 of this report.

Special examinations answer the question: Do the Corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively? A significant deficiency is reported when there is a major weakness in the Corporation's key systems and practices that could prevent it from having reasonable assurance that its assets are safeguarded and controlled, its resources are managed efficiently and economically, and its operations are carried out effectively.

### Key systems and practices examined and criteria

At the start of this special examination, we presented the Corporation's Audit committee with an audit plan that identified the systems and practices, and related criteria, that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. These are the systems and practices and criteria that we used for our special examination.

These criteria were selected for this examination in consultation with the Corporation. They were based on our experience with performance auditing—in particular with our special examinations of Crown corporations—and on our knowledge of the subject matter. Management reviewed and accepted the suitability of the criteria used in the special examination.

Key systems and practices examined	Criteria
<p><b>Governance</b></p> <ul style="list-style-type: none"> <li>• Appointment and functioning of the Board and its committees</li> <li>• Information for Board decision making and oversight</li> <li>• Internal audit</li> <li>• External relations</li> <li>• Corporate ethics</li> </ul>	<p>To maximize the Corporation's effectiveness and its ability to balance public policy with its commercial objectives, the Corporation has a well-performing corporate governance framework that meets the expectations of best practices in board stewardship, shareholder relations, and communication with the public.</p>
<p><b>Strategic planning</b></p> <ul style="list-style-type: none"> <li>• Corporate planning process</li> </ul>	<p>The Corporation has clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandate. Its strategic direction and goals take into account government priorities, identified risks, and the need to control and protect its assets and manage its resources economically and efficiently.</p>
<p><b>Performance measurement and reporting</b></p> <ul style="list-style-type: none"> <li>• Key performance indicators</li> <li>• Reporting of performance achieved</li> </ul>	<p>The Corporation has identified performance indicators to measure the achievement of its mandate and statutory objectives. It also has reports that provide complete, timely, and balanced information for decision making and accountability reporting.</p>
<p><b>Enterprise risk management</b></p> <ul style="list-style-type: none"> <li>• Enterprise risk management process</li> </ul>	<p>The Corporation has a focus on risk embedded in its corporate culture. That focus should be pervasive at all levels of the Corporation and should support the realization of its mandate, business goals, and objectives. Risks should be identified, measured, mitigated, monitored, and reported in order to be kept within a level appropriate to the nature of the business.</p>
<p><b>Lending</b></p> <ul style="list-style-type: none"> <li>• Loan portfolio risk management</li> <li>• Pricing of products</li> <li>• Loan initiation and approval</li> <li>• Loan operational review</li> <li>• Specific and general allowance processes</li> <li>• Application of the <i>Canadian Environmental Assessment Act</i></li> </ul>	<p>The Corporation has portfolio management and pricing policies, procedures, and controls clearly defined.</p> <p>The Corporation identifies credit risk problems, estimates credit impairment in the portfolio, and monitors and reports on the overall credit risk of the portfolio on an ongoing basis.</p> <p>The Corporation considers the environment and sustainable development when it makes lending decisions and manages its portfolio.</p>
<p><b>Treasury and investment management</b></p> <ul style="list-style-type: none"> <li>• Treasury risk management and reporting</li> <li>• Cash flow management system</li> <li>• Borrowing system</li> <li>• Venture capital strategy</li> </ul>	<p>Treasury strategies and programs for funding, investment, and risk management are consistent with corporate objectives and risk tolerances. The Corporation identifies, quantifies, and manages risk exposures.</p> <p>The Corporation monitors and reports Treasury transactions and activities to management and to the Board, at levels appropriate to these exposures.</p> <p>Venture capital investment activities permit the Corporation to select its initial investments according to strategic objectives, and monitor exiting investments to ensure the optimization of exit opportunities and to meet the planned risk and profitability of these investments.</p>

Key systems and practices examined	Criteria
<p><b>Human resources</b></p> <ul style="list-style-type: none"> <li>• Human resource planning and forecasting</li> <li>• Succession planning framework</li> <li>• Performance compensation practices</li> <li>• Related performance measurement</li> <li>• Training and development process</li> <li>• Communication with employees</li> </ul>	<p>Human resources are managed in a manner that provides the Corporation with the human resource capacity and the work environment needed to achieve its goals and objectives.</p>
<p><b>Information technology</b></p> <ul style="list-style-type: none"> <li>• IT project management practice and project management office methodology</li> <li>• IT strategic planning and operational planning process and practice</li> <li>• Information security process</li> <li>• Service level management process (software development, incident management, and performance management)</li> <li>• Disaster and business continuity process</li> </ul>	<p>The planning, development, implementation, and management of information technology and information management systems support the Corporation's strategic and operational objectives, ensure business continuity, and satisfy information needs on a timely basis.</p>

**Period covered by the special examination**

The special examination covered the systems and practices that were in place between May 2011 and February 2012. However, to gain a more complete understanding of the significant systems and practices, we also examined certain matters that preceded the starting date of the special examination.

**Audit team**

Assistant Auditor General: Clyde M. MacLellan  
 Principal: Marise Bédard  
 Lead Director: Patrick Polan  
 Director: Bernard Battistin

Patrick Charbonneau  
 Eva Jarzyna  
 Jessica Perkins  
 William Xu

For information, please contact Communications at 613-995-3708 or 1-888-761-5953 (toll-free).

## Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
<b>Corporate governance</b>	
<p><b>37.</b> Farm Credit Canada should further develop its Board self-assessment to help identify ways to improve practices, competencies, and skills that are essential for the Board and its committees. (33–36)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada will work with the Board to enhance the competency self-assessment process in the 2013–14 fiscal year. This will include expanding the process to the committee level with consideration given to the Board competency profile requirements.</p>
<p><b>38.</b> Farm Credit Canada’s Board of Directors should, in collaboration with Corporation management, identify opportunities for more training. FCC should provide this training to help directors fully understand the Corporation’s affairs and play the Board’s oversight role. (33–36)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada will work with the Board to implement this recommendation. Future training will be more deliberately planned and linked to the outcomes of the enhanced Board competency self-assessment process.</p>
<hr/> <b>Strategic planning, performance measurement, and reporting</b>	
<p><b>56.</b> Farm Credit Canada should assess its performance in achieving critical outcomes and strategic objectives. (48–55)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada will undertake a comprehensive review of critical outcomes and strategic objectives in the 2012–13 fiscal year planning cycle and expand its performance measures to be more outcome-oriented.</p>
<hr/> <b>Enterprise risk management</b>	
<p><b>70.</b> Farm Credit Canada should extend its approach to integrated risk management through the creation of a position of Chief Risk Officer. (63–69)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada will pursue the creation of a Chief Risk Officer position in the 2013–14 fiscal year.</p>

Recommendation	Response
<b>Lending</b>	
<p><b>86.</b> Farm Credit Canada should develop a strategy and action plan for ensuring compliance with its Environmental Risk Management Policy. (83–85)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada is committed to address remaining knowledge and compliance gaps through execution of a detailed strategy and action plan commencing in the 2012–13 fiscal year.</p>
<b>Treasury and investment management</b>	
<p><b>99.</b> Farm Credit Canada should develop a capital management policy and should set up the necessary systems and processes to manage this policy. (92–98)</p>	<p><b>The Corporation’s response.</b> Agreed. A formal Capital Management Framework project is currently under way to further enhance FCC’s capital management practices.</p>
<b>Human resources</b>	
<p><b>118.</b> Farm Credit Canada should include for Board approval all elements of its total cash compensation (base salary, pay-at-risk percentage, and performance component) and the total compensation envelope. The Board should also be informed of the final compensation results compared with the approved envelope. All exceptions to the policy should be reported to, and approved by, the Board. (112–117)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada will, in the 2012–13 fiscal year, review its Board disclosure of total cash compensation to ensure completeness and transparency.</p>
<p><b>119.</b> Farm Credit Canada should consider improving the disclosure of its compensation framework in its Annual Report. (112–117)</p>	<p><b>The Corporation’s response.</b> Agreed. Farm Credit Canada is committed to continuously improving disclosure and transparency in external reporting. A review of compensation-related Annual Report content will be conducted relative to industry peers and best practices by 31 March 2013.</p>