



Report of the Auditor General of Canada to the Parliament of Canada

Independent Auditor's Report

Export Development Canada's Environmental
and Social Review Directive



Office of the
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Introduction

Background

Export Development Canada

1. Export Development Canada is Canada's official export credit agency. The mandate of this Crown corporation is to support and develop Canada's export trade and Canadian capacity to engage in that trade and respond to international business opportunities. The Corporation does this by providing trade finance and risk mitigation services to Canadian exporters and investors, alongside other export credit agencies and private-sector financial institutions. To ensure consistency and fairness, the Corporation must operate under guidelines and principles that are in line with those adopted by other market players.

2. Export credit agencies such as the Corporation seek to promote trade in a competitive environment. They can play a significant role in international trade and finance in developing countries that may not have well-established requirements for environmental and social risk management. For example, these agencies are a major source of international public financing for large-scale infrastructure and resource extraction projects in the developing world.

Environmental and social review of projects

3. Since 2001, the *Export Development Act* has required the Corporation to carry out environmental reviews of project-related transactions. To respond to this obligation, the Corporation introduced the Environmental Review Directive. Under this directive, before entering into a project-related transaction, the Corporation must consider possible adverse environmental effects.

4. The directive was amended in November 2010 to become the Environmental and Social Review Directive. Exhibit 1 shows the requirements of the directive for projects that the Corporation reviews. Exhibit 2 shows the transactions assessed under the directive in the last four years.

Exhibit 1—How the Environmental and Social Review Directive applies to large project-related transactions at each stage of a review

| | |
|---------------------------------|--|
| Screening | <p>The Environmental and Social Review Directive applies to large project-related financing, political risk insurance, or equity transactions entered into by the Corporation. For the directive to be applicable, the transaction must have a repayment term of two years or more, be related to a project, and either have a value of more than SDR10 million or be located in or near a sensitive area.</p> <p>For financing transactions where the total capital cost of a project is greater than US\$10 million, the Corporation will review the project according to the requirements of the directive.</p> |
| Classification | <p>The Corporation categorizes projects according to their potential adverse impact:</p> <p>Category A: Projects likely to have significant adverse environmental and social effects that are sensitive, diverse, or unprecedented. The impact may extend beyond the project site and be irreversible.</p> <p>Category B: Projects with less adverse potential environmental and social effects than Category A projects. The effects are usually site-specific. Few if any of the effects are irreversible, and in most cases mitigation measures can be designed.</p> <p>Category C: Projects likely to have minimal or no adverse environmental and social effects.</p> |
| Information requirements | <p>The Corporation reviews environmental and social information provided by the project sponsors. The required documentation varies according to the category of a project.</p> <p>Category A: The project normally requires an environmental and social impact assessment, or elements of such an assessment, to assist the Corporation in identifying and assessing potential adverse environmental and social effects.</p> <p>Category B: The project requires less information than a Category A project. The amount of information depends on the project.</p> <p>Category C: The project generally does not require an environmental and social impact assessment.</p> |
| Evaluation | <p>At a minimum, the project must comply with the host country's environmental and social standards. For Category A or B projects in non-G7 countries, the Corporation uses International Finance Corporation (IFC) Performance Standards as well as any relevant internationally recognized sector-specific or issue-specific standards not addressed by the IFC Performance Standards.</p> |
| Determination | <p>The Corporation must determine whether</p> <ul style="list-style-type: none"> • a project is likely to have adverse environmental or social effects despite the implementation of mitigation measures; and • it is justified in entering into the transaction, despite these effects. <p>Following are possible grounds for supporting a project despite adverse environmental and social effects after mitigation measures:</p> <ul style="list-style-type: none"> • After the mitigation measures, the adverse environmental and social effects are not significant. • The Corporation is satisfied that the project is designed to meet or exceed internationally recognized good practices, guidelines, or standards. • The project represents an opportunity to improve environmental conditions in the host country above baseline conditions. • The project provides an opportunity to transfer environmentally sound technologies, services, and knowledge to, or for the benefit of, the host country. |
| Covenants and monitoring | <p>The Corporation negotiates financial agreements to include appropriate covenants, warranties, and monitoring provisions. Each agreement sets out requirements for monitoring the execution of the project.</p> |

Exhibit 1—How the Environmental and Social Review Directive applies to large project-related transactions at each stage of a review (continued)

Definitions:

Group of Seven (G7)—Informal grouping of seven industrialized nations (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) and the European Union.

International Finance Corporation (IFC)—A member of the World Bank Group, focused exclusively on the private sector in developing countries. Its Policy and Performance Standards on Environmental and Social Sustainability help project sponsors identify, evaluate, avoid, mitigate, and manage environmental and social risks and impacts.

Project—For the purposes of the directive, a physical development of a previously undeveloped site, or a major extension or transformation of an existing project. The project may be either planned or occurring, and may be industry-related, commerce-related, or infrastructure-related.

SDR (Special Drawing Right)—An international reserve asset established by the International Monetary Fund to supplement its member countries' official reserves. Its value is based on a basket of five major national currencies. On 19 April 2019, SDR1.00 was equal to CAN\$1.85.

Exhibit 2—Transactions subject to environmental and social review processes under the Corporation's Environmental and Social Review Directive

| Type of transactions | Number of transactions | | | |
|----------------------|------------------------|------|------|------|
| | 2015 | 2016 | 2017 | 2018 |
| Category A* | 3 | 3 | 1 | 2 |
| Category B* | 3 | 7 | 8 | 8 |

* See Exhibit 1 for an explanation of categories A and B.

- The Corporation also established other environmental and social review processes for transactions not covered by the directive (Exhibit 3). These other review processes are not within the scope of this audit.

Exhibit 3—Other environmental and social review processes of the Corporation

| Process | Description |
|--------------------------------------|---|
| Environmental and social risk review | This review applies to transactions with a value of US\$5 million or more related to general and multi-purpose corporate credit facilities, political risk insurance, and medium- and long-term insurance transactions, as well as transactions not covered by the Environmental and Social Review Directive. |
| Officer screening | Financing officers and underwriters screen transactions of less than US\$5 million to evaluate whether a transaction should be subject to an environmental and social risk review. |
| Automated review | This review applies to transactions identified by the Corporation as having minimal environmental risk based on the nature, size, and duration of the financing. |
| Exporter declaration | For insurance and bonding transactions, the Corporation requires a declaration from clients that they are not aware of significant environmental risks associated with the business that the Corporation is being asked to support. |

Note: More than one of these processes may apply. For example, while exporters complete a declaration for contract insurance and bonding transactions, a transaction might still need to undergo an environmental risk review if it meets certain thresholds or criteria.

6. In addition to requiring reviews, the directive and other processes enable the Corporation to verify that the projects include mitigation measures, where relevant, to reduce potential negative impacts. In this way, the Corporation fulfills its statutory requirements and ensures that the projects it funds meet international standards for environmental and social protection.

7. The Corporation's current environmental and social risk management framework has the following components:

- The Environmental and Social Risk Management Policy sets out the Corporation's commitment to assess environmental and social risks in the transaction decision-making process, to advocate for best practices with its counterparts, and to strive for high standards of mitigation and monitoring of supported projects, without unduly hindering the Corporation from supporting Canadian companies as they compete in global markets.
- The Environmental and Social Review Directive requires the Corporation to carry out environmental and social reviews of certain project-related transactions.
- Other processes, as defined in the Environmental and Social Risk Management Policy, supplement the directive. They apply to other project-related transactions and non-project transactions.
- The Corporation's Disclosure Policy sets out broad disclosure requirements as well as requirements specific to certain projects reviewed under the directive.

Previous reviews

8. Under the *Export Development Act*, the Auditor General of Canada must audit the design and implementation of the Corporation's Environmental and Social Review Directive at least once every five years and submit a report to the Corporation's Board of Directors, the Minister of International Trade Diversification, and Parliament. This is our fifth report on the directive. In our June 2014 report, we found that the Corporation's environmental and social review processes had most elements of a suitably designed environmental and social review framework, and that they were operating as designed.

Changes since our 2014 audit

9. Environmental and social risk management practices have continued to evolve at the Corporation. Among other things, it adopted the United Nations Guiding Principles on Business and Human Rights; and in 2013, it implemented a Human Rights Due Diligence Procedure and Guideline (updated in 2017), which sets out the requirements for assessing human rights issues associated with transactions. In May 2018, the Corporation launched a review of its Environmental and Social Risk Management Policy, which is expected to be completed by the end of 2019. In our review, we examined the directive as amended in November 2010.

10. The Corporation adheres to the Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (generally referred to as the “Common Approaches”). The Common Approaches were developed by the Organisation for Economic Co-operation and Development (OECD). These are a set of recommended procedures and processes for export credit agencies to follow when they conduct environmental reviews of projects for which they have provided support. The OECD published a new version of the Common Approaches in 2016. One of the main changes is the addition of social considerations in transaction screening. Specifically, if a member country identifies a high likelihood of severe human rights impacts related to a project in a transaction, the transaction should be screened according to the scoping requirements of the Common Approaches.
11. The Corporation adopted the Equator Principles—that is, a set of voluntary guidelines developed by the global banking industry to assist financial institutions in identifying and evaluating environmental and social risks associated with large-scale projects to which they may provide support. The principles are currently under review and a new version is expected to be released in 2019.

Focus of the audit

12. This audit focused on Export Development Canada’s Environmental and Social Review Directive, particularly
- the suitability of the design of the directive, and
 - the implementation of the directive.
13. This audit is important because, as Canada’s export credit agency, the Corporation is in a position to contribute to the achievement of Canada’s climate change and human rights commitments. It should therefore ensure that it complies and promotes compliance with internationally recognized environmental and social standards.
14. We did not examine the Corporation’s broader Environmental and Social Risk Management Policy, which covers other processes related to environmental and social reviews of transactions into which the Corporation enters. We also did not examine other due diligence processes related to anti-bribery and anti-corruption.
15. More details about the audit objective, scope, approach, and criteria are in **About the Audit** at the end of this report (see pages 15–17).

Findings, Recommendations, and Responses

Overall message



16. Overall, we found that Export Development Canada designed its Environmental and Social Review Directive to meet international standards for environmental and social protection in transactions funding overseas projects. However, we noted opportunities for the Corporation to explicitly articulate how the directive applies to human rights issues, to demonstrate how host country requirements (if applicable) meet international standards, and to include provisions in its directive similar to the additional requirements found in the Equator Principles.

17. We also found that the Corporation met the requirements for classifying, categorizing, assessing, and monitoring transactions subject to the directive. However, we found that project agreements did not always specify monitoring requirements, and the Corporation did not always document the basis for its project classification decisions.

Design of the Environmental and Social Review Directive

Context

18. In December 2003, Canada and other member countries of the Organisation for Economic Co-operation and Development (OECD) adopted what is now known as the Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (generally referred to as the “Common Approaches”). The OECD Common Approaches have become the recognized principles under which export credit agencies are expected to extend officially supported export credits.

19. In addition, in 2007 the Corporation adopted the Equator Principles, originally formulated in 2003 by 10 members of the private banking sector. The aim was to ensure that projects receiving financing from financial institutions were developed in a manner that was environmentally sound. The Equator Principles have become the standard to be followed by private-sector financial institutions with regard to environmental and social impacts of transactions funded by them.

20. By following both the Common Approaches and the Equator Principles, Export Development Canada ensured that its practices were in line with those of other market players, including export credit agencies and private-sector financial institutions.

21. The Corporation issued its Environmental and Social Review Directive in response to the requirements of the *Export Development Act*. In addition, it developed a suite of other review processes addressing environmental and social risks related to transactions that were not within the scope of the directive.

The Environmental and Social Review Directive met the requirements of the Common Approaches developed by the Organisation for Economic Co-operation and Development

What we found

22. We found that the directive's scoping, classification, review, evaluation, decision-making, and monitoring processes met the recommendations of the OECD Common Approaches, and were aligned with the Equator Principles. Opportunities existed for the Corporation to clarify how human rights issues were considered in the screening and classification processes of the directive, as well as to demonstrate how host country requirements ensured compliance with the International Finance Corporation (IFC) Performance Standards.

23. Our analysis supporting this finding presents what we examined and discusses the following topics:

- Integration of human rights impacts into the screening and classification process
- Applicable standards
- Additional requirements of the Equator Principles

Why this finding matters

24. This finding matters because environmental and social issues are becoming increasingly important to Canadians and international stakeholders. For this reason, it is critical to have a properly designed process for classifying, assessing, and monitoring projects that may have significant environmental or social impacts or risks. With such a process, it is possible to identify and address these risks.

Recommendations

25. Our recommendations in this area of examination appear at paragraphs 29, 34, and 39.

Analysis to support this finding

26. **What we examined.** We examined whether Export Development Canada's Environmental and Social Review Directive (2010 version) met international standards for environmental and social protection. To do this, our audit benchmarked the directive against the 2016 version of the OECD Common Approaches and the 2013 version of the Equator Principles.

27. **Integration of human rights impacts into the screening and classification process.** According to the 2016 version of the OECD Common Approaches, the likelihood of severe project-related human rights impacts should be considered when assessing a transaction for potential environmental or social risks (for comparison, see Exhibit 1, Classification).

28. The Corporation's Environmental and Social Review Directive does not specifically mention project-related human rights impacts as a screening criterion. Currently, the directive refers to a suite of social impacts to be considered in screening and project classification and outlines the approach for classifying projects. Additional detail appears in the Corporation's Human Rights Due Diligence Procedure and Guideline, which outlines the human rights due diligence approach for all of the Corporation's business, whether project-related or not.

29. **Recommendation.** In the Environmental and Social Review Directive, the Corporation should revise the criteria for screening and classifying a transaction to include a criterion for the existence of a high likelihood of project-related human rights impacts, in line with the Common Approaches.

***The Corporation's response.** Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released an overarching and dedicated Human Rights Policy that is fully aligned with the United Nations Guiding Principles on Business and Human Rights. The policy codifies the Corporation's approaches to due diligence and outlines principles on the use of leverage, enabling remediation as well as the Corporation's commitments to increase transparency and a level playing field. The Corporation's Human Rights Due Diligence Procedure and Guideline (2017) provides details on how the Corporation undertakes human rights screening for all Category A and B projects. The results of the project-related human rights screening serve to (1) identify whether there might be a high likelihood of actual or potential severe project-related human rights impacts resulting from projects under consideration and (2) inform the focus of analysis for benchmarking and categorization of projects. Hence consideration of the severity of the impacts on people is fully integrated as part of the Corporation's due diligence for project-related transactions. The Corporation recognizes that the Environmental and Social Review Directive (also revised and released in May 2019) and the Human Rights Policy and associated procedures and guidelines could better articulate how they are interrelated. The Corporation will review the procedures and guidelines to ensure that they are clear regarding how severe project-related human rights impacts are considered and will reflect any updates as part of the next review.*

30. **Applicable standards.** According to the Common Approaches, projects should always comply with host country standards and also meet the international standards against which they have been benchmarked. (In most cases, these are the World Bank safeguard policies or the IFC Performance Standards.) Projects may be benchmarked against the relevant aspects of other internationally recognized standards provided they are more stringent than the World Bank and IFC standards.

31. The Equator Principles deal with this issue differently: For projects taking place in certain designated countries, the applicable standard will be host country laws, regulations, and permit requirements. Such projects in designated countries are not required to meet international standards.

32. The provisions of the Environmental and Social Review Directive are consistent with the Equator Principles approach. For a project in one of the Group of Seven member countries, the directive states that the Corporation may decide no further information is needed from the project sponsor if the Corporation is satisfied that the project has been designed in compliance with host country environmental and social requirements. In such cases, compliance with the World Bank policies and IFC standards is not assessed because the host country requirements are assumed to be as stringent as those standards.

33. This approach creates a risk for the Corporation that a project may not fully comply with the World Bank policies and IFC standards against which it should have been benchmarked.

34. **Recommendation.** In order to meet the recommendations of the Common Approaches, the Corporation should revise the Environmental and Social Review Directive to specify that, if the host country requirements for a given country or project are accepted as the applicable standard, they must be shown to be more stringent than the international standards against which that country or project is otherwise expected to be benchmarked.

***The Corporation's response.** Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released an updated Environmental and Social Review Directive. The new directive has eliminated all clauses referring specifically to the Group of Seven to ensure greater consistency between obligations under the Corporation's directive and the requirements of the Common Approaches and the Equator Principles. The Corporation now makes a determination under the directive for all projects regardless of country. With regard to whether host country regulations are in accordance with international standards, the Equator Principles recognize certain countries that are deemed to have robust environmental and social governance, legislative systems, and institutional capacity. The list of designated countries is widely accepted by the international finance community. The Equator Principles working group of financial institutions seeks to ensure that a robust environmental*

and social risk assessment framework is maintained. These are the minimum standards for the Corporation's review of designated countries, and are consistent with international practice for financial institutions. The Corporation agrees to consider how host country regulations compare with the international standards they supersede when it undertakes assessments under the Environmental and Social Review Directive.

35. **Additional requirements of the Equator Principles.** Transactions that might trigger a review under the Equator Principles were outside the scope of this audit. For these transactions, the Corporation had a supplementary process (Exhibit 3) to ensure that, in its reviews, the Corporation addressed Equator Principles requirements not covered by the directive. We noted some areas where the directive did not comply with the expectations of the Equator Principles.

36. For example, the scope of the Equator Principles extends beyond project-specific loans to require review of project-related corporate loans—that is, any loan where most (but not all) of the funding is for a single project. In contrast, the Corporation's directive refers only to loans that are 100% related to a project. This narrows the scope of the directive and the number of transactions to which it would apply.

37. For all Category A and (as appropriate) Category B projects, the Equator Principles require independent review of assessment documentation, including the environmental and social impact assessment, regardless of whether the documentation was prepared by project sponsor staff or an external consultant. In contrast, for a Category A project, the Common Approaches specify that the same party should not both complete and review an environmental and social impact assessment. The Corporation's directive requires independent review in cases where the environmental and social assessment was completed by employees of the project sponsor or project company. In this respect, the directive may be interpreted as aligned with the Common Approaches, but the Equator Principles appear to be more stringent.

38. The Equator Principles require independent monitoring and reporting after the provision of a loan; this is to ensure ongoing compliance over the life of the loan for Category A and (as appropriate) Category B projects. The Common Approaches require monitoring and reporting, but they do not mandate the involvement of an independent environmental and social consultant or a qualified, experienced external expert. The Corporation's directive states that, if the Corporation imposes conditions, it will ensure that proper monitoring takes place; however, the directive does not provide for independent review of the monitoring information (Exhibit 4).

Exhibit 4—In some areas, the Corporation's directive did not align with the Equator Principles

| Area | Requirements | | |
|--|---|--|---|
| | Equator Principles | Common Approaches | Corporation's directive |
| Scope (transactions subject to review) | Loans where at least 50% of the funding is for a single project | Export credits related to projects | Loans where 100% of the funding is for a single project |
| Review of assessment documentation | Independent review required for Category A and (as appropriate) Category B projects | Independent review required for Category A projects only | Independent review required if employees of the project sponsor or company performed the assessment |
| Monitoring | Independent monitoring and reporting required | Monitoring and reporting required, but not necessarily by independent consultant or expert | Monitoring required in some cases, but no mention of independence |

39. **Recommendation.** In its Environmental and Social Review Directive, the Corporation should consider including provisions similar to the additional requirements found in the Equator Principles regarding scope, independent review, and monitoring.

***The Corporation's response.** Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released updates to the Environmental and Social Review Directive after an extensive policy consultation and review. As a result of the review, the Corporation refined the scope of the directive to align with the Equator Principles, specifically as it pertains to project-related corporate loans. This means that the Corporation will consider any loan for which at least half the financing is directed to project-specific activities to fall within the scope of the directive. The Corporation agrees with the recommendation to consider how independent review and monitoring can be further refined and will use subsequent reviews of the directive to articulate the approach.*

Implementation of review processes

The Corporation classified and monitored projects in accordance with the Environmental and Social Review Directive

What we found

40. We found that transactions to which the Corporation's Environmental and Social Review Directive applied were classified, assessed, and monitored in accordance with it, but the Corporation could improve the documentation of its monitoring terms and of its screening decisions.

41. Our analysis supporting this finding presents what we examined and discusses the following topics:

- Testing of transactions
- Testing of monitoring activities
- Testing the exclusion of transactions

Why this finding matters

42. This finding matters because by classifying projects correctly, assessing the project design against expected standards, and monitoring implementation, the Corporation can ensure that the projects it finances comply with environmental and social requirements.

Context

43. Between 1 October 2016 and 30 September 2017, as part of a social responsibility audit, the Corporation's internal audit group audited design, implementation, and operating effectiveness of the controls found in the Environmental and Social Review Directive, and tested nine transactions. The report on the social responsibility audit discussed the requirements for site visits and further defined "material compliance" in the context of monitoring activities.

Recommendations

44. Our recommendations in this area of examination appear at paragraphs 49 and 53.

Analysis to support this finding

45. **What we examined.** We examined whether the Environmental and Social Review Directive enabled the Corporation to identify and monitor projects that might involve environmental or social risks.

46. **Testing of transactions.** We examined a sample of 8 transactions falling within the scope of the directive and found that the transactions examined were classified, assessed, and approved in accordance with the directive. We found that the files supporting the transactions selected for our review included the elements required to demonstrate compliance with the directive and with recognized international benchmarking standards.

47. **Testing of monitoring activities.** Terms for subsequent monitoring were included in agreements only where gaps were found regarding the applicable international standards and where management action plans to address those gaps were being implemented. We examined monitoring activities for six transactions that were classified, assessed, and approved under the directive. Not all transactions were subject to monitoring after approval, and recent transactions would not yet have been monitored. For these reasons, the transactions examined for monitoring were different from the transactions examined for classification, assessment, and approval (see paragraph 46).

48. In some cases, we found that loan agreements did not clearly set out the monitoring rights and requirements. This made it difficult for the Corporation to enforce monitoring requirements so that it could ensure continued compliance of the projects it was funding. In our 2014 audit, we noted that monitoring reviews and follow-ups should be carried out in a timely manner.

49. **Recommendation.** In the loan agreements, the Corporation should clearly specify the terms for monitoring requirements.

***The Corporation's response.** Agreed. The Corporation has taken action on this issue and will develop additional guidance on drafting environmental and social monitoring covenants.*

50. **Testing the exclusion of transactions.** We selected a sample of 13 transactions not classified within the scope of the directive, to assess whether the Corporation's decision to exclude these transactions from the scope of the directive was appropriate. We exercised our judgment in selecting the transactions from the Corporation's public disclosure of transactions. We based our choice on each transaction's dollar value, the general description, and the industry concerned. We focused on transactions with a higher likelihood of meeting the scoping criteria of the directive.

51. We noted that only financing entirely related to a project was considered for classification under the directive. This excluded financing that had been requested not specifically for a project or that was not entirely related to it, even if a portion of the financing might be used for a project. In such a case, the financing would be reviewed according to other processes. Such transactions were not within the scope of the directive and thus were not within the scope of our audit.

52. In examining financing transactions that were not project-related, we reviewed the documentation supporting the decision to screen the financing request as being outside the scope of the directive. We found it was sometimes difficult to understand the basis on which the Corporation had decided that a transaction was not project-related and thus not subject to the directive.

53. **Recommendation.** The Corporation should ensure that it fully documents its decisions about the screening of financing transactions to specify whether they are subject to the Environmental and Social Review Directive.

***The Corporation's response.** Agreed. The Corporation has taken action on this recommendation and will develop additional guidance on recording conclusions when it considers corporate financing transactions to be outside the scope of the directive.*

Conclusion

54. We concluded that Export Development Canada's Environmental and Social Review Directive was suitably designed, as it met the requirements of the Organisation for Economic Co-operation and Development's Common Approaches and was aligned with the Equator Principles.

55. We also concluded that the Environmental and Social Review Directive was implemented as designed for the period from 1 September 2018 to 28 February 2019.

About the Audit

This independent assurance report was prepared by the Office of the Auditor General of Canada on Export Development Canada's Environmental and Social Review Directive. Our responsibility was to provide objective information, advice, and assurance to assist Parliament in its scrutiny of the government's management of resources and programs, and to conclude on whether the directive complied in all significant respects with the applicable criteria.

All work in this audit was performed to a reasonable level of assurance in accordance with the Canadian Standard for Assurance Engagements (CSAE) 3001—Direct Engagements set out by the Chartered Professional Accountants of Canada (CPA Canada) in the CPA Canada Handbook—Assurance.

The Office applies Canadian Standard on Quality Control 1 and, accordingly, maintains a comprehensive system of quality control, including documented policies and procedures regarding compliance with ethical requirements, professional standards, and applicable legal and regulatory requirements.

In conducting the audit work, we have complied with the independence and other ethical requirements of the relevant rules of professional conduct applicable to the practice of public accounting in Canada, which are founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour.

In accordance with our regular audit process, we obtained the following from entity management:

- confirmation of management's responsibility for the subject under audit;
- acknowledgement of the suitability of the criteria used in the audit;
- confirmation that all known information that has been requested, or that could affect the findings or audit conclusion, has been provided; and
- confirmation that the audit report is factually accurate.

Audit objective

The objective of this audit was to determine whether Export Development Canada's Environmental and Social Review Directive was designed to include activities and practices consistent with the Organisation for Economic Co-operation and Development (OECD) Common Approaches and with the Equator Principles.

As required under section 21(2) of the *Export Development Act*, our audit objectives addressed

- the suitability of the design of the directive, and
- the implementation of the directive, to determine the extent to which the requirements set out in it were being met.

Scope and approach

In line with our approach for the 2014 audit, we evaluated the Corporation's Environmental and Social Review Directive (2010 version) by comparing it with the OECD Common Approaches and the Equator Principles (the internationally recognized standards for practices in the area of environmental and social review). To assess the suitability of the design of the directive, we examined whether it met the recommendations of the Common Approaches and was aligned with the Equator Principles where relevant, recognizing that both the Common Approaches and the Equator Principles provide for similar screening, classification, review, evaluation, decision-making, and monitoring activities. We also reviewed how the Corporation had responded to the recommendations in our 2014 report.

Since the scope of our audit was limited to the directive, we did not look at the design of the Corporation's other environmental and social review processes, and our findings and conclusion do not extend to those processes.

We conducted interviews with management of the Corporation and reviewed documents, including policies, procedures, committees' terms of reference, minutes, and reports. We compared the elements of the directive and other environmental and social review processes and procedures with each of the elements of the OECD Common Approaches and the Equator Principles (including the requirements of the International Finance Corporation Performance Standards on Environmental and Social Sustainability, where appropriate). We also tested a sample of transactions for compliance with the directive.

Criteria

| Criteria | Sources |
|---|---|
| To determine whether Export Development Canada's Environmental and Social Review Directive was suitably designed, we used the following criteria: | |
| The Corporation's Environmental and Social Review Directive meets the requirements of the Organisation for Economic Co-operation and Development (OECD) Common Approaches and the Equator Principles. | <ul style="list-style-type: none">• Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence (generally referred to as the "Common Approaches"), OECD• Equator Principles, The Equator Principles Association |
| To determine whether Export Development Canada's Environmental and Social Review Directive was implemented as designed, we used the following criteria: | |
| The Corporation complies with the requirements of its Environmental and Social Review Directive. | <ul style="list-style-type: none">• Environmental and Social Review Directive, Export Development Canada, 2010 |

Period covered by the audit

The audit covered the period between September 2018 and March 2019. This is the period to which the audit conclusion applies. However, to gain a more complete understanding of the subject matter of the audit, we also examined certain matters that preceded the starting date of this period.

Date of the report

We obtained sufficient and appropriate audit evidence on which to base our conclusion on 16 April 2019, in Ottawa, Canada.

Audit engagement leader

Lissa Lamarche

List of Recommendations

The following table lists the recommendations and responses found in this report. The paragraph number preceding the recommendation indicates the location of the recommendation in the report, and the numbers in parentheses indicate the location of the related discussion.

| Recommendation | Response |
|--|--|
| Design of the Environmental and Social Review Directive | |
| <p>29. In the Environmental and Social Review Directive, the Corporation should revise the criteria for screening and classifying a transaction to include a criterion for the existence of a high likelihood of project-related human rights impacts, in line with the Common Approaches. (27–28)</p> | <p>The Corporation’s response. Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released an overarching and dedicated Human Rights Policy that is fully aligned with the United Nations Guiding Principles on Business and Human Rights. The policy codifies the Corporation’s approaches to due diligence and outlines principles on the use of leverage, enabling remediation as well as the Corporation’s commitments to increase transparency and a level playing field. The Corporation’s Human Rights Due Diligence Procedure and Guideline (2017) provides details on how the Corporation undertakes human rights screening for all Category A and B projects. The results of the project-related human rights screening serve to (1) identify whether there might be a high likelihood of actual or potential severe project-related human rights impacts resulting from projects under consideration and (2) inform the focus of analysis for benchmarking and categorization of projects. Hence consideration of the severity of the impacts on people is fully integrated as part of the Corporation’s due diligence for project-related transactions. The Corporation recognizes that the Environmental and Social Review Directive (also revised and released in May 2019) and the Human Rights Policy and associated procedures and guidelines could better articulate how they are interrelated. The Corporation will review the procedures and guidelines to ensure that they are clear regarding how severe project-related human rights impacts are considered and will reflect any updates as part of the next review.</p> |

| Recommendation | Response |
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| <p>34. In order to meet the recommendations of the Common Approaches, the Corporation should revise the Environmental and Social Review Directive to specify that, if the host country requirements for a given country or project are accepted as the applicable standard, they must be shown to be more stringent than the international standards against which that country or project is otherwise expected to be benchmarked. (30–33)</p> <p>39. In its Environmental and Social Review Directive, the Corporation should consider including provisions similar to the additional requirements found in the Equator Principles regarding scope, independent review, and monitoring. (35–38)</p> | <p>The Corporation's response. Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released an updated Environmental and Social Review Directive. The new directive has eliminated all clauses referring specifically to the Group of Seven to ensure greater consistency between obligations under the Corporation's directive and the requirements of the Common Approaches and the Equator Principles. The Corporation now makes a determination under the directive for all projects regardless of country. With regard to whether host country regulations are in accordance with international standards, the Equator Principles recognize certain countries that are deemed to have robust environmental and social governance, legislative systems, and institutional capacity. The list of designated countries is widely accepted by the international finance community. The Equator Principles working group of financial institutions seeks to ensure that a robust environmental and social risk assessment framework is maintained. These are the minimum standards for the Corporation's review of designated countries, and are consistent with international practice for financial institutions. The Corporation agrees to consider how host country regulations compare with the international standards they supersede when it undertakes assessments under the Environmental and Social Review Directive.</p> <p>The Corporation's response. Agreed. The Corporation has been addressing this issue since 1 May 2019, when it released updates to the Environmental and Social Review Directive after an extensive policy consultation and review. As a result of the review, the Corporation refined the scope of the directive to align with the Equator Principles, specifically as it pertains to project-related corporate loans. This means that the Corporation will consider any loan for which at least half the financing is directed to project-specific activities to fall within the scope of the directive. The Corporation agrees with the recommendation to consider how independent review and monitoring can be further refined and will use subsequent reviews of the directive to articulate the approach.</p> |
| <p>Implementation of review processes</p> <p>49. In the loan agreements, the Corporation should clearly specify the terms for monitoring requirements. (47–48)</p> <p>53. The Corporation should ensure that it fully documents its decisions about the screening of financing transactions to specify whether they are subject to the Environmental and Social Review Directive. (50–52)</p> | |
| | <p>The Corporation's response. Agreed. The Corporation has taken action on this issue and will develop additional guidance on drafting environmental and social monitoring covenants.</p> <p>The Corporation's response. Agreed. The Corporation has taken action on this recommendation and will develop additional guidance on recording conclusions when it considers corporate financing transactions to be outside the scope of the directive.</p> |

