

Outstanding Recommendations

Assessment of Implementation Report

Agriculture Financial Services Corporation (AFSC)

Systems to Manage the Lending Program

(October 2016)

Summary of Recommendations

We assessed the four outstanding recommendations to AFSC from our October 2016 audit of its *Systems to Manage the Lending Program*. We found all four of the following recommendations have been implemented:

IMPLEMENTED Recommendation:

Define strategic objectives, articulate sector credit needs, and re-evaluate the relevance of the lending program

IMPLEMENTED Recommendation:

Define oversight responsibilities

IMPLEMENTED Recommendation:

Develop a funding model and costing system

IMPLEMENTED Recommendation:

Monitor the performance of the loan portfolio

Introduction

In 2016, we audited the Agriculture Financial Services Corporation's (AFSC) systems to manage, monitor and measure the performance of its lending program and made four recommendations on where AFSC needed to improve its processes.

In our assessment of implementation, completed in May 2020, we found AFSC implemented our four recommendations on:

- Define strategic objectives, articulate sector credit needs, and re-evaluate the relevance of the lending program
- Define oversight responsibilities
- Develop a funding model and costing system
- Monitor the performance of the loan portfolio

Since 2017, AFSC has defined the strategic objectives of the lending program, developed new policies and procedures, and improved its processes. It has also worked with the Department of Agriculture and Forestry to clarify the oversight responsibilities of both parties and provided quarterly reports to the department, and improved its risk management practices and reporting to monitor the performance of the loan portfolio.

Recommendation:

Define strategic objectives, articulate sector credit needs, and re-evaluate the relevance of the lending program

IMPLEMENTED

Context

Strategic objectives are the steps that an organization completes to achieve its ultimate goal. These objectives help shape and guide what an organization is, what it does and why it does it.

In 2016, we found that the Agriculture Financial Services Corporation (AFSC) lacked clearly defined strategic direction for the lending program. We also found that the credit needs of the agriculture sector had not been articulated clearly, and that AFSC had no systems to re-evaluate periodically the relevance of its lending products.

Current findings

AFSC implemented our recommendation to define strategic objectives, articulate sector credit needs, and re-evaluate the relevance of the lending program³⁹:

- AFSC has introduced periodic market needs assessments to identify the credit needs of Alberta's agriculture sector
- based on the results of the market needs assessment, AFSC defined the strategic objectives of its lending program
- AFSC developed a process to re-evaluate periodically the relevance of the lending products it offers.

In our followup, we found that AFSC conducted a market assessment in 2017 to identify the credit needs of Albertans. As part of that market assessment, AFSC conducted an online market research survey, held seven focus group meetings, and developed an industry catalogue to gather information on the nature and types of lending products and services offered by other financial institutions.

³⁹ *Report of the Auditor General of Alberta—October 2016, page 23*

Based on the results of the market assessment, AFSC developed a new lending mandate that was approved by the board of directors on November 2, 2017, and by the Minister of Agriculture and Forestry on January 18, 2018.

Additionally, AFSC introduced a policy, which includes a requirement for AFSC to complete a market assessment every two years. In 2019, AFSC carried out another market assessment to ensure the continued relevance of its lending products.

Recommendation:

Define oversight responsibilities

IMPLEMENTED

Context

At AFSC, oversight responsibilities are shared between the:

- Board of directors, which has oversight of AFSC's activities and management
- Responsible minister—in this case the Minister of Agriculture and Forestry—who has oversight of the board of directors

In 2016, we reported that oversight responsibilities of the AFSC board of directors, and the Department of Agriculture and Forestry were not clearly defined. We also found that the Department of Agriculture and Forestry did not formally communicate its performance expectations for the lending program to AFSC.

Current findings

AFSC has implemented our recommendation to define oversight responsibilities⁴⁰:

- AFSC has regularly updated its Mandate and Roles document, which defines the oversight responsibilities of both the minister of agriculture and forestry and AFSC board of directors
- there are continuous communications between the minister and AFSC that sets the performance expectations for the lending program
- AFSC board of directors is receiving periodic reporting that allows it to provide adequate oversight of the lending program

We found that the mandate and roles document was periodically updated with the most recent one signed by the minister and chair of the board in December 2019. We also found frequent correspondence from the minister to AFSC that set the minister's expectations for the lending program in general and for specific lending initiatives. AFSC also provides the minister with regular updates on its lending process and policies and its progress in advancing specific lending initiatives.

Over the last two years, AFSC has improved its Enterprise Risk Management systems and hired a chief risk officer. Currently under the improved ERM reporting, the oversight committees receive quarterly reports showing:

- Portfolio composition
- Loan portfolio trend analysis

⁴⁰ Report of the Auditor General of Alberta—October 2016, page 25

- Significant concentrations, including industry and product concentrations
- Level of arrears and loan loss provisions
- Strategic growth measures

Review of these reports provides the oversight committees with the tools to monitor the performance and manage the risks associated with the lending program.

Recommendation:

Develop a funding model and costing system

IMPLEMENTED

Context

At present, the government provides AFSC with an annual contribution based on the gap between budgeted revenues and expenses of the lending program. In financial 2020, AFSC received a \$7.4 million contribution from the government compared to \$12.9 million in 2019.

In 2016, we found that this funding model does not promote accountability because the government does not have sufficient information about how the contribution was used by AFSC. We also found that AFSC does not have a system to track the costs associated with individual lending products.

Current findings

AFSC has implemented our recommendation to develop a funding model and costing system⁴¹:

- AFSC has developed a new costing model for allocating direct and indirect lending costs to determine the cost of its lending products
- AFSC has a plan to move to a funding model where the lending program is self-sustainable

We found AFSC built a costing model where revenues and expenses are allocated to loans sub categories like farm and business loans. We also found that management developed reasonable and supportable assumptions for its allocation of revenues, direct and indirect costs. Under this costing model, AFSC is able to identify the profitability and sustainability of its various lending products.

Although the government funding to the lending program continues to be on a consolidated basis, we understand management developed a plan to reduce significantly the government funding for the program with the objective to make it self-sustainable.

Management provided us with its 2020–2025 five-year business plan that reflects a consistent reduction in government funding over the next three years, with no contribution from the government in the last two years. This plan has been approved by the board and was presented to the Minister of Agriculture and Forestry and to the ministry of Treasury Board and Finance in December 2019.

⁴¹ *Report of the Auditor General of Alberta—October 2016, page 29*

Recommendation:

Monitor the performance of the loan portfolio

IMPLEMENTED

Context

The loan portfolio review function assesses whether the credit policy provides adequate guidance for lending activities, determines whether lending officers are following the loan policy, and provides independent reporting to senior management and the board on the quality of the loan portfolio. To provide an objective assessment, the loan portfolio review function should be independent of the loan approval process.

In 2016, we found that AFSC did not have an independent function to monitor the performance and the quality of the loan portfolio.

Current findings

AFSC has implemented our recommendation to monitor the performance of the loan portfolio.⁴²

We found AFSC significantly improved its lending policies and procedures, and introduced a new lending product governance policy. The policies have introduced several compliance, monitoring and reporting procedures. These procedures include transactions review, high-risk accounts reporting, periodic credit reviews, and exception and non-compliance reporting. These procedures were primarily carried out by officers who are independent from the loan approval process and reported to either the Chief Financial and Innovation Officer, the Chief Risk Officer, or to the board of directors.

We reviewed a sample of these reports and conclude that the newly introduced policies and procedures provide adequate independent monitoring and reporting on the performance and quality of the loan portfolio.

⁴² *Report of the Auditor General of Alberta—October 2016*, page 29