

Chapter 12

Special Report for the Crown Corporations Committee

NB Agriexport Inc.

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Special Report for the Crown Corporations Committee NB Agriexport Inc.

Background

12.1 NB Agriexport Inc. is a Crown agency established in 1996 under the Business Corporations Act of New Brunswick. It is an agricultural trade development company which is backed by the resources of the provincial government. It facilitates exporters' access to international markets and helps exporters manage the risks of international marketing.

12.2 Officials from NB Agriexport Inc. appeared before the Crown Corporations Committee on 22 September 1999. This was the first time the Corporation had been invited to meet with the Committee.

12.3 Following the completion of all Committee meetings, the Standing Committee on Crown Corporations issued its report to the Legislative Assembly. The Committee made the following background comments:

NB Agriexport is a bit of a virtual company in that its operations are closely tied with the operations of the Department of Agriculture. The Committee is concerned that the figures presented in the financial statements of the company may represent an inaccurate accounting of activities, as it appears that expenditures of the Corporation are actually being borne by the Department of Agriculture and Rural Development.

12.4 The Committee recommended that a full examination of the operation and accountability of NB Agriexport Inc. be carried out by the Auditor General.

Scope

12.5 The scope of our audit was dictated by the wording of the recommendation submitted by the Crown Corporations Committee. Once the request to conduct this audit was accepted, the first priority was to translate this audit request into terms that could be used in an audit to fully address the concerns of the Committee.

12.6 Audit benchmarks were established in the form of six audit criteria. Audit criteria are seen as reasonable and attainable standards of performance and control that can be used to assess the adequacy of systems and practices. They were discussed with the staff of the Department of Agriculture and Rural Development in advance of the commencement of the audit fieldwork.

12.7 The audit approach involved a combination of interviews and meetings with appropriate staff of the Department. It also involved a review of documentation related to the establishment and the operation of the Corporation.

Results in brief

12.8 The Corporation should prepare and issue an annual report in accordance with the requirements of the provincial annual report policy.

12.9 We concluded that all activities in which the Corporation has been involved to date are consistent with the mandate and strategic objectives of the Corporation.

12.10 No formal update to the business plan has been submitted to the Board of Management for approval, since the original plan was approved in 1996.

12.11 The Corporation should take appropriate action to ensure there is no confusion between the role of management and the role of the board of directors. This could be done by substituting outside board members for departmental employees who currently sit on the board.

12.12 The board should ensure that management prepares and reports performance information including performance indicators and an evaluation of the achievement of the indicators.

12.13 Interest expense on the advance from the Province should be recorded in compliance with the terms of the 1996 business plan or, if appropriate, the business plan should be changed to agree with current practice.

Accountability

12.14 Our first evaluation criterion was:

There should be a process in place whereby the Corporation is accountable to the Legislative Assembly for all of its activities.

What is accountability?

12.15 There are many valid ways of defining accountability. A general definition of accountability is the obligation to render an account for a responsibility conferred.

12.16 From the perspective of the Legislative Assembly, receipt of the following information would provide the necessary accountability information:

- a clear explanation of the operations of an organization;
- an indication of what it was expected to accomplish;
- an indication of how the success will be measured; and
- feedback on the performance showing how expectations were met.

12.17 Evidence should be made available to the Legislative Assembly each year to allow a regular assessment of the performance of an entity.

Is NB Agriexport Inc. being accountable?

12.18 According to the Province's policy for annual reports, the prime function of the report is to be the major accountability document by departments and agencies for the Legislative Assembly and the general public.

12.19 The Province's annual report policy suggests the following should be shown:

- a clear account of goals and objectives;
- performance indicators;
- the extent to which the program is relevant;
- how well the Corporation performed in achieving its plans;
- how well it was accepted by its client groups; and
- budget and actual financial information and explanations of differences.

12.20 No annual report has been prepared by the Corporation since its inception, so the Corporation has not been in compliance with provincial policy.

12.21 The 1999 annual report of the Department of Agriculture and Rural Development mentions NB Agriexport Inc., however the information set out in the report does not meet the annual report requirements from the perspective of the Corporation. No accountability information is provided about the Corporation.

12.22 At the present time the only information available to legislators is the annual audited financial statements of the Corporation. There is no reference in these financial statements to goals or expectations and there is no reference to how well the Corporation did in relation to their goals. The financial statements do not include budget information to allow a comparison between expected activity and actual results.

12.23 An important part of the existing accountability process is the annual meeting with the Crown Corporations Committee. As a Crown agency of the Province, NB Agriexport Inc. can be asked to appear before the Committee. In the case of the Corporation, this did not take place following either the 1996-97 or the 1997-98 years. However, members of NB Agriexport Inc. did meet with the Committee members when requested, following the completion of the 1998-99 year.

12.24 The meeting with the Crown Corporations Committee is a process that involves a question and answer format but there is no formalized approach directed towards answering how well the Corporation did in comparison with its plan. Distribution of a corporate annual report in advance of these meetings has the potential to provide significant improvement to the effectiveness of the meetings. With the assistance of a properly prepared annual report, the Committee's questions would better evaluate and challenge the annual operations of the Corporation and ultimately improve the accountability process.

Assessment of the criterion based upon the audit

12.25 The Corporation appeared as requested before the Crown Corporations Committee during the year, however its major accountability document should be the annual report and no report has been issued. As a result, this criterion has been only partially met.

Recommendation

12.26 **The Corporation should prepare and issue an annual report in accordance with the requirements of the provincial annual report policy.**

Approved activities

12.27 Our second evaluation criterion was:

All activities carried out by the Corporation should be anticipated and allowed under its approved mandate.

12.28 We examined the articles of incorporation, the Business Corporations Act and the corporate bylaws to establish the restrictions and the requirements under which the business of the Corporation is carried out. The articles of incorporation neither set restrictions on the operation of the Corporation nor established required business practices. The Business Corporations Act and the bylaws describe requirements of the Corporation in terms of administration but do not describe, limit or specify the nature of the business to be carried on by the Corporation.

12.29 It is the business plan of the Corporation that provides the description of their approved mandate. No other source of authority provides substantive guidance on the business of NB Agriexport Inc.

12.30 The business plan describes a number of activities in which NB Agriexport Inc. will participate. A comparison of this list to the activities that the Corporation has actually been involved in shows some differences. The major difference was the decision to be involved in equity ownership, which took place in the 1999-2000 year. Business ownership was not anticipated in the listed activities in the business plan. It should be noted however that this business decision did not come about without authority. In fact the Board of Management approved the investment. It is the Board of Management that approved the business plan itself.

12.31 The other difference between the business plan and actual practice was that the Corporation was expected to grant lines of credit.

In fact this practice has not been used to date and funding was given instead in the form of working capital advances.

12.32 The mandate and strategic objectives of the Corporation are general in nature and leave room for a variety of activities that could successfully lead to improvement in international trade in the agriculture industry. Based on the review of all activities in which the Corporation has been involved to date, we concluded that they are consistent with the mandate and the strategic objectives of the Corporation.

***Assessment of the criterion
based upon the audit***

12.33 Given that the corporation's activities are carried out in compliance with the mandate approved by Board of Management, this criterion has been met.

Compliance

12.34 Our third evaluation criterion was:

The Corporation should comply with all of its reporting and accountability requirements.

12.35 The Corporation's 1996 business plan sets out reporting and accountability requirements. The business plan was approved by the Board of Management on 4 September 1996. It requires that the annual financial statements of the Corporation be audited by the Office of the Auditor General. It is also required that the audited financial statements be reported in volume III of the Public Accounts for the Province. Audited financial statements have been published in the Public Accounts for each of the three years in which the Corporation has operated.

12.36 Another requirement of the business plan was that it would be updated on an annual basis. It stated:

An updated annual business plan reflecting the corporation's income and revenue will be submitted to Board of Management for review and approval.

12.37 The business plan also stated:

A business plan is an evolving document and as such will be updated on a regular basis to incorporate major new development opportunities.

12.38 Staff of the Corporation have been preparing regular updates of certain aspects of the business plan. These comprehensive documents contain much of the same type of information that was included in the original plan. They are provided to NB Agriexport Inc. board members for information purposes at each meeting, but the board does not officially approve them.

12.39 No formal update to the business plan has been submitted to the Board of Management for approval, since the original plan was approved in 1996.

12.40 The requirement for Board of Management approval of all project financing levels was also recognized under the approved business plan. This requirement extends to a case by case approval by the Board for all future requests for loans and loan guarantees. NB Agriexport Inc. has reported to the Board as anticipated and has received the necessary Board approval for all loans and loan requests.

Assessment of the criterion based upon the audit

12.41 Although the Corporation has complied with the majority of the requirements of the 1996 business plan, it has not prepared the required annual plan updates for the approval of the Board of Management. In addition NB Agriexport Inc. has not prepared required corporate annual reports. Therefore this criterion has been only partially met.

Recommendation

12.42 **An updated business plan should be submitted to the Board of Management and approved on an annual basis in compliance with the terms of the approved 1996 business plan.**

Governance

12.43 Our fourth evaluation criterion was:

There should be a structure in place that promotes effective governance of the Corporation.

Action to ensure that the objectives are met and that performance is satisfactory

12.44 Normal board and management relationships would see the board involved in approving major policy, while management will be involved in ensuring the policy is carried out as approved. While boards are focussed on the long term and the larger picture, management tends to work on the shorter term and the associated intricacies of management. The role of the board is to monitor results while management conducts business in an approved manner. There is a distinction between the responsibilities of the two levels.

12.45 NB Agriexport Inc. has an unusual structure. The Board of Directors is led by the Minister of the Department. Also serving on the Board of Directors are the Deputy Minister, the Assistant Deputy Minister and the Director of Corporate Services, all from the Department. There are three representatives from other government departments.

12.46 Being mainly composed of employees of the Department, it is possible for the board to play an active role in the administration of the program as well as conducting traditional board responsibilities. With the lack of separation of responsibilities between the board and management, the potential exists for confusion between the roles of the Board of Directors and staff of the Department.

12.47 One of the responsibilities of a board is to evaluate the performance of management. Given the existing composition of the board, this would result in having several of the board members effectively evaluate themselves. While the board has not requested that management provide information to facilitate monitoring of the

achievement of objectives, there is evidence that the board is aware of the deficiency. A previous board member was quoted in the minutes of meetings as recommending that due consideration be given to measurable activities and targeted goals. No changes took place as a result of these comments.

Fulfilling accountability obligations

12.48 NB Agriexport Inc. provides a clear explanation of the purpose of the organization through its business plan. The plan also explains what it wishes to accomplish and it puts forward a corporate mission, a mandate and strategic objectives. Together these lay the groundwork for a sound accountability process.

Accountability to the Board of Management

12.49 The first level of accountability for the Corporation is to the Board of Management. The business plan requires that project financing levels be approved by the Board. As well, all individual loans and loan guarantees are to be approved by the Board. Another accountability requirement in the business plan is for the Corporation to bring an updated business plan to the Board for approval each year. As mentioned earlier we are satisfied that the Corporation has been accountable to the Board of Management except for the fact that the original 1996 business plan was not updated and brought to the Board for approval as required.

Achievement of objectives

12.50 The NB Agriexport Inc. brochure indicates that the Corporation measures its performance by the successful business relationships that are fostered between international and domestic partners. This is a very important aspect of the business of NB Agriexport Inc. and certainly should form an integral part of both the strategic objectives of the Corporation and its performance measurement.

12.51 Although the Corporation has developed strategic objectives, it has not identified a means of measuring whether or not they have been achieved as planned. For instance one strategic objective identifies the intent to increase the number of New Brunswick companies exporting agriculture and agri-food products. Without performance measurement there is no way to measure and report on the success of the Corporation in achieving this.

12.52 To properly measure achievement, it is necessary to establish indicators of performance. It is difficult to report on how well the Corporation has performed when the means of measuring its success has not been defined. The result for NB Agriexport Inc. is that there is no organized reporting on performance.

Measurable strategic objectives

12.53 When establishing strategic objectives, it is important that they be stated in terms that can be meaningfully measured. Preparation of very broad or general objectives can make it difficult to link them to measurable performance. Two of the Corporation's existing strategic objectives may be of this nature:

- enhance the reputation of New Brunswick as a provider of top quality agricultural products; and
- attracting investment and technology to New Brunswick.

Defining who is accountable

12.54 An area of concern in the area of accountability is the potential for confusion due to the overlapping of roles between the Corporation and the Department. The roles of NB Agriexport Inc. and the Marketing and Rural Development Branch of the Department are very similar. Based on interviews conducted during the audit, as many as twenty-one persons from the Department have participated to some extent in the operations to date. However the Corporation itself has no full time staff.

12.55 A more formal definition of the differences between the operation of the Corporation and the Department would improve the corporate accountability process and prevent misinterpretations and confusion on the part of legislators such as happened in the meetings of the Crown Corporations Committee.

Assessment of the criterion based upon the audit

12.56 The board of directors has been set up in such a way that the majority of the members are staff of the Department. As well the Corporation has not prepared performance measurement information and has not communicated this and the other required information to the Members of the Legislative Assembly in the proper form. As a result, this criterion has not been met.

Recommendations

12.57 The Corporation should take appropriate action to ensure there is no confusion between the role of management and the role of the board of directors. This could be done by substituting outside board members for departmental employees who currently sit on the board.

12.58 The board should ensure that management prepares and reports performance information including performance indicators and an evaluation of the achievement of the indicators.

12.59 Strategic objectives should be reviewed to ensure that they are clear enough to allow their achievement to be reasonably measured.

12.60 The Corporation should consider the following in respect of the annual report:

- performance information should be presented to legislators in an annual report to the Legislative Assembly;
- existing information on the purpose of the organization, the mission, the mandate and the strategic objectives (currently in the business plan) should be included in the annual report; and
- the annual report should make a clear distinction between the operations of NB Agriexport Inc. and the Department.

Expenses

12.61 Our fifth evaluation criterion was:

All significant expenses incurred by, or on behalf of, the Corporation should be recorded as expenses in the annual financial statements of the Corporation.

12.62 By far the largest component of NB Agriexport Inc. expenditure over the past three years is the cost of products exported (\$1,031,141). This represents 96% of the total costs of \$1,071,856 recorded to date. The corporate accounting policy is to record the export sales and corresponding expenditures in the accounts of NB Agriexport Inc. only when the Corporation is named as the exporter of the product. In some cases the Corporation facilitates the international trade and does not become the exporter.

Costs not included in the audited financial statements

12.63 In compliance with the stated accounting policy of the Corporation, there are a number of costs that have been excluded from the figures referred to above. On the other hand there is also an excluded cost which, according to the business plan, is required to be reported by the Corporation.

Costs excluded by accounting policy

12.64 There are no salaries or employee benefits costs charged to NB Agriexport Inc. The Corporation has a part-time general manager, a part-time financial analyst and as many as nineteen other departmental employees who work on NB Agriexport Inc. activities for varying percentages of their time. Calculating the actual salary costs that could be attributable to NB Agriexport Inc. is difficult because staff are often working on both departmental and corporate projects at the same time. There are no formal time records that would provide the necessary information to allow calculation of actual salary costs. Therefore estimation is required. Based on results of interviews of three key members of the administration of the Corporation, we estimate an annual salary cost of \$89,000.

12.65 Employee travel cost is another expense that is not always disclosed in the Corporation's financial statements. It is reported only in those cases where employee travel is recoverable (from Regional Development Corporation or Canadian International Development Agency) and it is included in order to match the travel cost with the associated cost recovery. Other travel costs are difficult to calculate in a precise manner. Once again the problem is that staff are working on both corporate and departmental goals at the same time and no means exists to separate the costs accurately. Interviews with staff were again used to make estimates that could be used for this audit. Using the information received in the three interviews, we estimate an annual cost of \$9,900.

Excluded cost that should be reported

12.66 The business plan indicates that the Corporation is permitted to make working capital advances to qualified recipients. The Province advances these funds to the Corporation at an interest rate of between 4.75% and 5.25%, depending on what financing can be arranged. The

Corporation in turn advances these funds at slightly higher rates and retains the interest received. No expense has been recorded or paid for the interest on the funds advanced by the Province since the inception of the Corporation. Corporation staff point out that they have been in contact with the Department of Finance about this matter. A bill for interest due was discussed but none was issued. Since the charging of interest is set out in the approved business plan and there has been no official change to this requirement, it is appropriate to conclude that the interest could be considered an annual cost of operating NB Agriexport Inc. Using a rate of 5% and using the amount due to the Province at 31 March 1999, \$1,588,000, there would be an annual interest cost of \$79,400.

Other excluded costs

12.67 There are many other amounts that could be attributed to the operations of the Corporation. For example data processing, communications, printing, copying, rentals, postage, translation, general office and equipment costs could be accounted for. However due to the relatively small nature of these costs, no detailed calculations were attempted. Instead, a simple assignment of costs incurred within the branch was made using the percentage of salary cost assigned to the Corporation relative to the total personnel costs of the branch. The result was an estimated annual cost of \$18,000.

12.68 No attempt was made to assign a value to other items including legal, audit and accommodation costs.

Summary of estimated unrecorded annual costs

Salaries and employee benefits	\$ 89,000
Travel costs	9,900
Administration costs	18,000
Interest costs	<u>79,400</u>
Total	\$196,300

Conclusion

12.69 The audited financial statements are prepared on a basis that does not include all costs associated with the operation of the Corporation. The audited financial statements explain this in a note, as follows:

The administration of the Corporation's affairs is carried out by employees of the Province of New Brunswick under the direction of the Corporation's Board of Directors. All costs associated with these employees are paid by the Province.

12.70 There are significant costs not shown in the financial statements as a result of this accounting policy. Our examination also disclosed that the annual interest cost of holding an advance from the Province has not been recorded. If all costs associated with the operation of the Corporation were considered, the costs would be roughly double the level at which they are shown now.

12.71 The 1996 business plan indicates that all revenues generated by the Corporation are to support new export marketing projects. The Province is absorbing the majority of the administration costs and it is only because of this that it has been possible to recognize net revenues. It should be noted that an accounting policy such as that adopted by NB Agriexport Inc., which sees salary and administrative costs excluded from the financial statements, is also seen in other New Brunswick Crown agencies.

Assessment of the criterion based upon the audit

12.72 There is a large value of expenses incurred by or on behalf of the Corporation that has not been recorded in the financial statements. Therefore this criterion has not been met.

Recommendations

12.73 The corporate financial statements should include an accounting for all significant costs.

12.74 Interest expense on the advance from the Province should be recorded in compliance with the terms of the 1996 business plan or, if appropriate, the business plan should be changed to agree with current practice.

Revenues

12.75 Our sixth evaluation criterion was:

All significant revenues earned by the Corporation should be recorded in the annual financial statements of the Corporation

12.76 NB Agriexport Inc. records two types of income, export sales and other income. Total export sales revenue recorded in the three years of operation is \$839,767. Other income totals \$279,610.

12.77 Export sales are made up entirely of cattle and seed potato sales. As mentioned in the expenses section, the Corporation has the policy of recording transactions as export sales only when NB Agriexport Inc. itself is the exporter. Sales which are facilitated, but for which the Corporation was not the exporter and for which the Corporation charged no administration fee, are not shown as sales of the Corporation and as a result are not reflected in the financial statements in any way.

12.78 Administration or facility fees are charged in conjunction with certain of the contracts facilitated by NB Agriexport Inc. The fees are paid under the authority of the agreements signed with the producers. These fees are referred to in the 1996 business plan as management fees that are normally charged at a rate of 1.5% of the value of the contract negotiated. Staff indicated that this rate is considered as a guideline.

12.79 The business plan states:

NB Agriexport Inc. works with the New Brunswick exporters to help them identify market opportunities, make appropriate contacts in the target markets, and negotiate contracts for

export sales. It is paid for these services by charging a management fee, normally 1.5% of the value of the contract.

12.80 There have only been two cases thus far where the 1.5% fee has been charged. However there are cases where deals have been facilitated but the fee has not been charged. The Department, rather than the Corporation, deals with these cases. According to staff, the Corporation would only get involved when a loan guarantee or working capital advance is involved. There may be potential for further cost recovery by also charging the management fee in cases where other types of assistance have been provided to businesses.

12.81 There is no documented policy that covers situations where anything lower than the 1.5% management fee can be charged nor is there guidance to explain all situations in which it is appropriate to recover costs.

12.82 Based on our review, our conclusion is that the financial records of the Corporation capture all significant revenue it has earned.

***Assessment of the criterion
based upon the audit***

12.83 This criterion has been met.

Recommendation

12.84 Current policy should clearly explain the situations in which NB Agriexport Inc. can assess the management fee. Policy should also cover a description of those situations where percentages lower than 1.5% can be used.