3.13 Loan Guarantees - Department of Finance

Introduction

Government uses loan guarantees to achieve its policy objectives. When Government provides a loan guarantee on behalf of a company, it is guaranteeing or promising that it will repay a loan on behalf of the company if that company cannot repay the loan. There are no payments made by Government when the guarantee is issued. Payments will only be made if the company defaults on its loan payments and the financial institution requires Government to honour its guarantee.

The Province has guaranteed the repayment of principal and interest of debentures and bank loans on behalf of municipalities, companies, individuals and Crown corporations. These guarantees may be used to support regional development or to provide economic assistance to companies or individuals. Corporate and municipal guarantees are ratified each year by an amendment to the *Loan and Guarantee Act, 1957* or the *Local Authority Guarantee Act, 1957.*

Figure 1 outlines the total amount of loan guarantee limits and the related present liability for each of the last five years. The loan **"Guarantee Limit"** represents the maximum exposure under the Province's guarantee, with the **"Present Liability"** representing the actual outstanding amount relating to the guaranteed debt.

Figure 1

Loan Guarantees
Years Ended 31 March
$ Billions

Year	Guarantee Limit	Present Liability
1996	1.70	1.68
1997	1.74	1.72
1998	1.71	1.70
1999	1.56	1.56
2000	1.68	1.62

Source: Public Accounts of the Province

As can be seen from Figure 1, at 31 March 2000 loan guarantees were in place with limits totaling $1.68 billion, the present liability of which was $1.62 billion. Figure 2 provides information on these guarantees.

Figure 2

Loan Guarantees
31 March 2000
$ Millions

Form of Guarantee		Limit of Guarantee	Present Liability
Guaranteed Bank Loans			
	Corporate - Crown Corporation	$ 113.45	$ 101.49
	Corporate - Private Sector	9.23	3.16
	Municipalities	1.94	0.80
	Fisheries	24.14	23.04
Guaranteed Debentures			
	Municipalities	1.60	1.60
	Crown Corporations	1,487.22	1,487.22
Other Guarantees (i.e. performance)		42.99	7.00
Total		$ 1,680.57	$ 1,624.31

Source: Public Accounts of the Province

Guaranteed bank loans relate to municipal, fisheries and corporate loans. Municipal loan guarantees represent interim financing for municipal capital projects. Fisheries loan guarantees represent interim financing provided through bank loans during a vessel's construction period and term loans once construction has been completed. Corporate loan guarantees are provided by Government to qualifying companies.

Guaranteed debentures relate to debentures issued to the Municipal Development and Loan Board and the Canada Mortgage and Housing Corporation on behalf of municipalities as well as debentures of several Crown corporations most notably the Newfoundland and Labrador Hydro Electric Corporation and the Newfoundland Municipal Financing Corporation.

Other guarantees relate to performance guarantees the Province had in place with respect to three shipbuilding/repairs contracts Newfoundland Ocean Enterprises Limited had entered into at the Marystown shipyard facilities. The contracts were assumed by Friede Goldman Newfoundland Limited at the time the assets of Newfoundland Ocean Enterprises Limited were purchased; however, the Province's performance guarantees were not released. The company did indemnify the Province with regard to these guarantees through third party performance bonding. As at 31 March 2000, Government's exposure with respect to two of the contracts had effectively ended due to the associated work being completed in accordance with those contracts. Government's exposure with respect to the third contract has significantly decreased given that all work has been completed. Government's exposure is now limited to any construction issues which may arise in the future.

For purposes of this report, we have focused on private sector corporate loan guarantees which total $9.23 million as of 31 March 2000.

The amount of the Province's loan guarantees are disclosed as contingent liabilities in the Province's Public Accounts, with a detailed listing presented in a Schedule. Loan guarantees do not directly affect the Province's cash position until a payment is required under the guarantee. At that time the payment is recorded as an expenditure of the Province. Payments totaling $13 million were made during the year ended 31 March 2000.

A valuation allowance is recorded in the Public Accounts each year representing the Province's estimate of payouts which may be required relating to guaranteed debt. The allowance as at 31 March 2000 was $1.6 million.

Figure 3 outlines the payment amounts and allowance in each of the past five years. In addition to the payout of $7.8 million for the year ended 31 March 1999, the Province assumed as its own debt, $81.1 million in debt owed by Newfoundland Ocean Enterprises Limited ($70.9 million) and Newfoundland Farm Products Corporation ($10.2 million). Both of these amounts were assumed as the Province's own debt as they were guaranteed by the Province.

Figure 3

Loan Guarantee Payments and Allowance
Years Ended 31 March
$ Millions

Year	Payment under Guarantee	Valuation Allowance
1996	11.0	-
1997	0.8	66.8
1998	0.2	87.0
1999	7.8	14.4
2000	13.0	1.6

Source: Public Accounts of the Province

Also, guarantees have been provided to private companies by the Enterprise Newfoundland and Labrador Corporation.

Scope and Objectives

We commenced our review of loan guarantees in January 2000. Our review included discussions with departmental officials, and a review of relevant authorities, policies and procedures, agreements, reports and other departmental information. As well, specific loan guarantees were reviewed with primary emphasis on Corporate guarantees.

The objectives of our audit were to examine the Province's loan guarantees to assess the nature and objectives of the loan guarantee program, whether guidelines and related policies and procedures had been developed and were consistent with the nature and objectives of the program, whether program guidelines and related policies and procedures that had been developed were being complied with, and whether monitoring and reporting mechanisms had been established to evaluate and report on success towards achieving program objectives.

3.13 Loan Guarantees - Department of Finance

Conclusions

For the period 1996 to 2000, Government's loan guarantee program has resulted in the payout or assumption of debt in excess of approximately $114 million, of which $95 million related to Crown corporations and $19 million related to private companies. Of the $114 million, $4.9 million was recovered from four Crown corporations relating to the sale of four middle distance fishing vessels. Government's involvement with these vessels resulted in costs totalling $35.6 million in guarantee payouts and other related costs. A total of $12,700 was also recovered through realization of security Government had in place for a $73,000 payout on a loan guarantee.

Figure 4 provides a summary of the activity in the Department of Finance's corporate loan guarantee portfolio for each of the last five years.

Figure 4

Department of Finance
Summary of Activity - Corporate Loan Guarantee Portfolio
Years Ended 31 March
$ Millions

Year	Limit of Guarantees	Present Liability	Number of Guarantees
1996	69.55	65.25	18
1997	86.07	81.67	17
1998	97.26	91.39	15
1999	21.48	17.97	12
2000	122.68	104.65	14

Source: Public Accounts of the Province

The most significant changes in Figure 4 occurred between 1998 and 1999 and between 1999 and 2000. The decrease in the total amount guaranteed between 1998 and 1999 is primarily due to the assumption of $70.9 million in debt resulting from the divestiture of Newfoundland Ocean Enterprises Limited and $10.2 million in debt resulting from the divestiture of Newfoundland Farm Products Corporation. The increase in the total amount guaranteed between 1999 and 2000 is primarily due to the guarantee of $110 million in debt relating to the Health Care Corporation of St. John's relating to the Corporation's site relocation and renovation project.

As of 31 March 1999 there were loan guarantees to 12 private companies totalling $21.5 million. We reviewed 6 of the12 loan guarantees which accounted for $18.5 million. Our review of these guarantees extended to May 2000.

In 1990, Cabinet established criteria which companies are required to meet before the Province will provide loan guarantee assistance. The Department of Finance developed policies to address these criteria. However, we found that some of the policies are not specific enough. For example the criteria established by Cabinet requires that the company satisfactorily demonstrate that it can be viable over the long term. However, there is nothing in the policies to tell staff how to determine viability. Cabinet also provided that criteria could be waived in cases where there would be significant community impact. Again, there is no guidance in the policies to tell staff what would constitute significant community impact.

Our review also indicated that the criteria established by Cabinet is not always being complied with. For example:

- Three of the six loan guarantees reviewed did not meet the criteria approved by Cabinet. The three companies were not established businesses as required by Cabinet criteria and one of the three companies used its loan guarantee to secure term financing which was not permitted by Cabinet. Of these three guarantees, two resulted in payouts totalling $18 million.

- While Cabinet directed that guarantees normally would not exceed a one year duration, most loan guarantees are being issued without expiry dates. Of the private companies examined which received loan guarantees, the average length of time the company had been in receipt of a loan guarantee was 6.3 years. Two guarantees had been in place for in excess of 10 years with the longest of these two in effect for 13 years. One other guarantee has been outstanding approximately 8 years.

3.13 Loan Guarantees - Department of Finance

Monitoring of loan guarantees requires improvement. Some of the significant issues identified include:

- Although guarantee agreements require audited financial statements to be submitted, our review of files maintained by the Department indicated that the files did not always contain recent audited financial statements.

- There is no formal mechanism in place to ensure that the financial position of companies receiving loan guarantees is being reviewed on a regular and current basis. The Department's reviews are generally completed when a company's year end financial statements are received. Since this information is not received in a timely manner, significant periods of time may pass between reviews.

- Loan guarantee recipients did not always have appropriate insurance in place as required by the guarantee agreement. There is also no system in place to remind Department of Finance staff when a policy is expiring and thus prompt them to request evidence that insurance coverage is in place.

Corporate and municipal loan guarantees are approved by Cabinet and tabled in the House of Assembly; however, fisheries loan guarantees are approved by the Fisheries Loan Board and are not approved by Cabinet or tabled in the House of Assembly. As at 31 March 2000, fisheries guaranteed bank loans totalled $24.1 million.

Cabinet criteria specifies that security must be available to government on a book value basis to the value of the loan guarantee either through the company or personal guarantees of the principals. Our review indicated that assets taken as security are usually insufficient to cover the loan guarantee and are often subordinated to other creditors. In addition, there is usually no action to realize on security held.

Some recipients of loan guarantees have also received loans and/or equity financing from the Department of Development and Rural Renewal. This increases the Province's total exposure in cases of default. There is no guidance as to when a company would receive a guarantee from the Department of Finance versus the Department of Development and Rural Renewal.

3.13 Loan Guarantees - Department of Finance

Findings and Recommendations

While the Department of Finance is involved in the administration of municipal and fisheries loan guarantees, it is primarily involved with the corporate loan guarantee portfolio.

1. Guidelines

In 1990, Cabinet provided direction for the process to be used by the Department of Finance with respect to the corporate loan guarantees portfolio. Under this authority, the Minister of Finance was authorized to set out in a Policy and Procedures Manual new guidelines for the portfolio. The guidelines were to include that proposals for guarantees could be accepted if they meet specified criteria, unless in the Minister's opinion extenuating circumstances exist.

The Department developed a Loan and Guarantee Program (Corporate) Procedures Manual which provides guidelines related to the criteria identified in the Cabinet direction. However, we found that the guidelines are not specific enough. For example:

- The guidelines require that the company satisfactorily demonstrate that it can be viable over the long term. However, there is nothing to tell staff how to determine viability.

- The guidelines provide for other criteria to be waived in cases where there would be significant community impact. Again, there is no guidance provided to staff as to what would constitute significant community impact.

- The guidelines provide direction in cases where a loan guarantee is about to expire; however, it does not provide any guidance on what steps are to be taken when a company applies for an increase in their loan guarantee.

- Neither the guidelines nor the guarantee agreements specify the process to be used in the assessment of the potential for reducing individual outstanding loan guarantees. This process may require negotiation with the banks.

2. Compliance with Guidelines

As of 31 March 1999, there were 12 corporate loan guarantees in place totalling $21.5 million. We selected 6 of those loan guarantees totalling $18.5 million for further review.

3.13 Loan Guarantees - Department of Finance

Our review of corporate loan guarantees in place at the Department of Finance indicated the following:

- Government's policy, as stated above, provides that guarantees normally would not exceed a one year duration. Loan guarantees for several private businesses were in place for significant periods of time. The average age of loan guarantees examined which were provided to private organizations was 6.3 years with the longest outstanding guarantee being 13 years.

- The criteria established by Cabinet for approval of loan guarantees is not being consistently adhered to in the application approval process. In three cases companies were provided loan guarantees although they did not meet all of the three main criteria. For example:

    - Two of the companies were not established businesses as required by Cabinet criteria; and

    - The third company was not an established business as required by Cabinet criteria and used its loan guarantee to secure term financing which was not permitted by Cabinet.

- Cabinet directed that a monitoring committee be established to closely monitor loan guarantees. The Committee was to consist of representatives from the Departments of Finance, Justice, Fisheries and Aquaculture, and Development and Rural Renewal.

  This Monitoring Committee was established; however, it has not met since November 1992. Monitoring procedures completed are conducted by the Debt Management Division of the Department of Finance. However, the procedures performed by the Debt Management Division are limited to desk reviews if financial information is received. In cases where desk reviews are performed, documentation is limited. On-site visits to the companies' premises are minimal.

- Obtaining adequate security for loan guarantees is important in protecting the Province's investment in cases where a default occurs. The direction provided by Cabinet specifies that security must be available to government on a book value basis to the value of the loan guarantee either through the company or personal guarantees of the principals.

However, we found the following:

- assets taken as security are usually insufficient to cover the loan guarantee;

- assets taken as security are often subordinated to other creditors;

- the Province usually does not take any action to realize on its security; and

- the Province does not ensure that insurance on assets pledged as security is renewed.

In 5 of the 6 cases examined the Province released or subordinated loan guarantee security to other creditors.

There was no evidence of any market valuation performed on assets pledged as security. Such an evaluation would enable Government to determine the market value of assets and consequently which assets should be used as security for the loan guarantee. It would also assist the Province in determining the extent to which it should obtain personal guarantees from the principals of the company.

Furthermore the Department does not conduct a credit check or obtain a statement of personal net worth from principals of the company prior to approving a loan guarantee. This would provide additional information on the collectibility of the personal guarantee should the company default on the loan guarantee. It would also allow the Department to determine the ability of the company to obtain equity financing from its principals and whether it is necessary for the company to obtain a loan guarantee from the Province.

3. Monitoring and Reporting

- Government's policy specifies that a status report must be maintained for the purpose of providing basic information on companies provided with loan guarantees, including a history of guarantees in terms of authorities, agreement dates and expiry dates. The report is also intended to keep track of current activity on loan guarantees. While Department staff do maintain such a report, it was not complete. For example, in five cases the report did not contain a record of Priority Agreements which subordinated the Province's security in favour of other creditors. The maintenance of complete and up to date information on companies provided with loan guarantees would assist in the monitoring and administration of the Province's loan guarantee portfolio.

- The financial position of companies with outstanding loan guarantees is not being regularly reviewed because the audited financial statements are not always being provided by companies as required by the loan guarantee agreements. In instances where audited financial statements are being provided, they are usually late and therefore not current. As a result, it is difficult for the Department to assess whether restrictions contained in the guarantee agreements were being complied with.

- Loan guarantee files contain little information on what monitoring procedures were performed although there is a checklist in the Departmental Manual for this purpose. For example, while there were some hand written notes and comments in the margins of the information received, we do not believe that this is sufficient for monitoring and assessment purposes.

- The Department requires that companies with loan guarantees maintain insurance to cover any assets pledged as security and that the Department be named as a beneficiary in case any insurance claim is made. In one case examined no evidence could be found in the Department's files confirming that the loan guarantee recipient had appropriate insurance in place. There is also no system in place to remind Department of Finance staff when a policy is expiring and thus prompt them to request evidence that insurance coverage is in place. Confirmation that appropriate insurance is in place is generally only requested from the company when the Department performs its annual review which is not conducted on a regular basis.

  Failure to ensure that insurance coverage is in place exposes the Province to significant risk in cases where the loan guarantee recipient suffers a major uninsured loss. If such a loss occurs, it is unlikely that the Province would have sufficient security in place to honour its loan guarantee.

- The Department does not produce an annual or other report that addresses the loan guarantee program. Aside from tabling information in the House of Assembly on corporate and municipal loan guarantees approved during the year, for ratification by an amendment to the *Loan and Guarantee Act, 1957* or the *Local Authority Guarantee Act, 1957* respectively, the only report that the Department makes is an annual report required by the *Financial Administration Act* as to which, if any, loan guarantees have defaulted or have been assumed during the previous year. This report does not provide information in such areas as the actual number of jobs saved or created or what economic benefits have resulted from the loan guarantee program. As well, the information tabled in the House of Assembly as amendments to the *Loan and Guarantee Act, 1957* and the *Local Authority Guarantee Act, 1957,* does not include details on all loan guarantees since information on fisheries guarantees is not tabled. These guarantees amounted to approximately $24.1 million as at 31 March 2000.

4. Other Issues

- Four recipients of loan guarantees have also received loans and/or equity financing from the Department of Development and Rural Renewal. The provision of multiple forms of assistance increases the Province's total exposure in cases of default.

  Related to this matter, there did not appear to be any clear guidance as to when a company would receive a guarantee from the Department of Finance or when they would receive a guarantee from the Department of Development and Rural Renewal. Companies receiving assistance from these departments were similar in terms of the nature of the requests and the characteristics of the companies' proposals. Both departments or their agencies have been providing loan guarantees for a significant period of time. We noted one case where it appears the loan guarantee was originally going to be provided by the Department of Finance but was instead provided by the Department of Development and Rural Renewal. There was no indication as to the rationale for the change in the source of the guarantee.

  The provision of multiple forms of assistance from different departments or agencies to the same company also results in a duplication of effort in analyzing loan guarantee applications, monitoring approved guarantees, as well as increasing the general administration effort.

Of those loan guarantees which were in default, there was one case where a company provided with a loan guarantee by the Department of Finance for $6.7 million, was also provided with a $3.1 million loan by the Department of Development and Rural Renewal. In this case, a loan guarantee payout was made by the Department of Finance totalling $6.5 million and the Department of Development and Rural Renewal had determined that it will not be able to collect the outstanding loan balance of $2.8 million.

- The loan guarantee files maintained by the Department of Finance on each company were not always complete. In one case where a loan guarantee had been provided for $1.0 million there were indications on file that a priority agreement had been put in place subordinating the Province's security to other creditors. No copy of the fully executed agreement could be found in the files maintained by the Department. When questioned if the priority agreement was actually executed, Department staff had to contact the law firm representing the company to obtain a copy of the agreement in order to determine if it had been executed.

  The files of loan guarantee applicants and recipients do not adequately document the decision making process. As a result it is often difficult or impossible to determine why the decision to approve a loan guarantee was made. We were advised that this information may be contained in related submissions to Cabinet, to which this Office is not permitted access.

  Analysis of information provided by applicants requesting loan guarantees, to determine if the information is reasonable and achievable, is not on file. For example, there was no evidence on file to indicate whether a company was determined to be viable or whether there was adequate security available in the case of default. Of those entities that submitted pro forma financial statements and cash flow projections, the projections were generally not met.

- A review of applications rejected by the Department was performed. During this review it was determined that the Department was justified in rejecting these applications as they did not meet the required criteria as set out in the direction from Cabinet.

In reviewing these rejections, we noted that in advising the applicants of the rejections, the Department has indicated in part that the Province has effectively terminated the provision of loan guarantees. This statement is not consistent with the results of our review, which disclosed that the Province has in fact continued to issue new corporate and fisheries guarantees.

Recommendations

The Department should:

- *comply with Cabinet direction and the Loan and Guarantee Program (Corporate) Procedures manual;*
- *update the Loan and Guarantee Program (Corporate) Procedures manual as required to reflect current policies and procedures;*
- *ensure that a mechanism is in place to allow for the orderly reduction of outstanding loan guarantees;*
- *ensure that there is proper security for loan guarantees;*
- *take prompt action to enforce it's security and personal guarantees when a default on a loan guarantee occurs;*
- *prepare a more detailed annual report indicating the performance of the loan guarantee program; and*
- *establish a system that will highlight when a major milestone is reached so that appropriate action can be taken.*

Department's Response

Overview

At March 31, 2000, the Province had ten corporate loan guarantees outstanding to private sector companies aggregating $9.23 million, of which the present liability was just $3.2 million. The number and amounts outstanding with respect to private sector guarantees has declined since the early 1990's, as Government has endeavored to move away from this type of financial assistance, and also as a result of strong economic growth, particularly in the resource based sectors. In comparison, at March 31, 1989 there were 34 corporate loan guarantees outstanding, and Government's liability was $64.7 million.

3.13 Loan Guarantees - Department of Finance

To provide direction with respect to private sector corporate loan guarantees, in 1990 Cabinet authorized the Minister of Finance to set out in a Policy and Procedures Manual new guidelines for commercial loan guarantees which would give guidance in determining the eligibility of applicants and establish criteria for evaluation and the development of recommendations for Cabinet decisions. It should be noted that this Cabinet direction provided a basic framework for considering loan guarantee requests, which could be varied or waived if, in the opinion of the Minister of Finance, extenuating circumstances existed, including those of a social nature, i.e. significant community impact. In essence, each subsequent request for a loan guarantee could, if approved, result in modifications to the previously approved guidelines.

All loan guarantees are reported on annually in the Financial Statements of the Province and the necessary legislative authority is received, where required, on a regular basis, pursuant to ratifications to The Loan and Guarantee Act, 1957 and The Local Authority Guarantee Act, 1957.

With this background in mind, we would like to offer the following responses with respect to the specific recommendations contained in your report.

Recommendation

The Department should comply with Cabinet direction and the Loan and Guarantee (Corporate) Procedures Manual.

Response

It is our view that we are in compliance with Cabinet direction, as well as the Loan and Guarantee Program (Corporate) Procedures Manual. Cabinet direction in 1990 stated that proposals for guarantees must meet the given criteria... "unless in the Minister's opinion extenuating circumstances exist". Of the six guarantees examined, two were approved before the guidelines were put in place by Cabinet, while three others were approved based upon extenuating circumstances. The following detail is provided with respect to those guarantees approved, where extenuating circumstances existed.

Company A (and its subsidiaries)

In 1997, Government privatized the chicken processing operations of Newfoundland Farm Products Corporation by turning it over to 20 chicken farmers located throughout the Province, who had become shareholders in the new company. In order to enable this new venture to access necessary capital and operating credit, Government provided loan guarantee support to achieve this public policy objective. While the company was new, it did take over an established operation.

Company B

Government has been encouraging the establishment and development of an aquaculture industry in the Province, especially since the declaration of the Northern Cod moratorium. Due to its natural advantages, the Bay d'Espoir area has been key to this goal, particularly with respect to finfish development. The company (located in Bay d'Espoir) is by far the largest player in this industry. Due to ongoing operating problems, a lack of working capital and a shortage of funding for capital projects, the company's financial position had become critical. In 1997, Government recognized that closure of this operation would have a major impact on the aquaculture industry and, as a result, it was necessary to assist this operation financially in order for it to survive. To accomplish this, a $6.7 million loan guarantee was provided for operating capital purposes. The company was an established business and, in any event, the loan guarantee was approved pursuant to the extenuating circumstances guidelines.

Company C

Government transferred a loan guarantee as part of an arrangement with this company to purchase a fish meal plant from another company. The second company was part of a group of companies, which had a $600,000 loan guarantee approved in 1992. With the impact of the Northern Cod moratorium, the group's financial position continued to deteriorate and it was likely that the guarantee would have to be honored. The Department was of the view that the new company's proposal to purchase the meal plant assets and assume a major portion of the group's loan offered an acceptable alternative as a going concern, and also reduced the possibility of a guarantee payout. The guarantee on behalf of the group of companies was reduced proportionately, with the new company taking over a significant portion of the loan. No new funding was provided under the guarantee, and the new company negotiated repayment terms with its bank.

Consequently, we are not in agreement with your comments since, under the circumstances, conversion of the operating credit guarantee to a term loan guarantee was an acceptable alternative.

- *With regard to your finding that guarantees are often in place for periods in excess of one year, we offer the following comments:*

    i. *Two of the guarantees in place were approved before the guarantee guidelines were established;*
    ii. *Once a guarantee is in place and an amount drawn down, the only way for Government to get out from under the guarantee is to pay out the loan. This would impact negatively on the financial position of the Province;*
    iii. *Certain guarantees have no expiry dates. This is considered on an individual basis and this practice is followed when it is more convenient for Government, the company and the bank;*
    iv. *The removal of the expiry dates in most cases was initiated to assist with the administration process and to avoid banks having to demand against the guarantees on an annual basis in order to protect amounts drawn down as of the expiry dates. Also, a demand to avoid any exposure at the expiry dates was viewed to be an unnecessary intrusion to companies that might otherwise have very satisfactory credit records.*

- *With respect to the inactivity of the Monitoring Committee, due to the substantial reduction in guarantees, in particular for companies in resource based industries, it was decided that the committee was no longer necessary. Despite this, however, interdepartmental consultations are undertaken when deemed appropriate.*

Recommendation

The Department should update the Loan and Guarantee Program (Corporate) Procedures manual as required to reflect current policies and procedures.

Response

- *The Procedures Manual will be updated to formalize procedures that are currently carried out by program staff, including;*

  i. *Guidelines used in the performance of annual reviews. It should be noted that regardless of Government's position, the financial institutions involved must be agreeable to any reductions in the guarantee; and*
  ii. *The recommended procedures and timetable for the regular monitoring of insurance policies.*

- *The determination of viability and community impact are considered in the analysis of the business plans and are noted and commented upon in the respective Cabinet Submission. It is our position that these factors are difficult to outline in a Procedures Manual and are more appropriately dealt with on a case by case basis.*

Recommendation

The Department should ensure that a mechanism is in place to allow for the orderly reduction of outstanding loan guarantees.

Response

- *Mechanisms and procedures are in place to provide for the orderly liquidation of loan guarantees. Our annual reviews include analysis of financial information, discussions with company management, updates of security and negotiations with the bank and company to reduce the amount of the outstanding loan guarantee, where feasible. The Procedures Manual will be updated to formalize these processes.*

- *It should be noted, however, that regardless of the mechanisms and procedures in place, it is the financial institution holding Government's guarantee that must agree to any reduction.*

Recommendation

The Department should ensure that there is proper security for loan guarantees.

Response

- *Best efforts are already undertaken to ensure all available security is provided to Government. Security normally includes chattels, personal guarantees, properties, intangibles and shares in other companies, where appropriate;*

- *Subordination of security positions (or for certain asset purchases) is part of the normal course of business for funding agencies and programs. It is normally the case that the additional assets and funding improves the operating efficiency of the company and reduces the risk to the Province under the respective guarantee;*

- *Market valuations of assets can be time consuming (therefore delaying approval) and expensive. In numerous cases, because of the location of the company/assets, these valuations would not provide meaningful information to Government. As most of the guarantees approved since 1990 are the result of extenuating or special circumstances, the process would be of minimal value;*

- *While the Department generally has not conducted credit checks, the companies do present short and long term debt positions in their proposals and/or business plans. As a result of the due diligence process, the Department is very familiar with the company and its banking relationships by the time a recommendation is made to Cabinet; and*

- *As noted, the Debt Management Division's status report does not include information on priority agreements. However, staff are obviously aware of these agreements as all related documentation has to be reviewed by Departmental staff and the Department of Justice prior to execution by the Minister. When the Province's ranking with respect to its security does become an issue, the necessary searches are undertaken on our behalf by the Department of Justice.*

Recommendation

The Department should take prompt action to enforce its security and personal guarantees when a default on a loan guarantee occurs.

Response

- *As pointed out in your report, a paper is presented to Cabinet before each payout to inform Cabinet of the circumstances of the payout as well as to seek direction with respect to the possible disposition of security;*

- *It is often the case that, due to the value of the assets, location, etc. the enforcement of security would be very expensive, such that funds would not cover the costs;*

- *It may also be the case that Government's chances of recovering guarantee defaults is enhanced if the company is permitted to continue operations;*

- *In the case of Company B, Government, as a means of continued support to the aquaculture industry and to meet its policy objectives, did not enforce its loan guarantee security. Instead, Government has offered to write off the debt and release its security if the company meets certain conditions. Government considers this course of action to offer the best chance of ensuring the continued operation of the company, the improvement of its financial position and the further development of the aquaculture industry in the Province;*

- *Company A (and its subsidiaries) were placed into receivership shortly after Government demanded payment in full under its security. No payment was received from the receiver as there have been no funds available to allocate to the Province. Under the circumstances no further collection activity is possible.*

Recommendation

The Department prepare a more detailed annual report indicating the performance of the loan guarantee program.

Response

- *All reports are presented to the House of Assembly as required by legislation. This includes the ratification of new guarantees, as well as increases and extensions of guarantees provided under authority of The Loan and Guarantee Act, 1957 and The Local Authority Guarantee Act, 1957. A list of all loan guarantee payouts is also tabled in the House of Assembly as required by the*

Financial Administration Act. The guarantees are also included in the Public Accounts of the Province.

- *In the case of loan guarantees involving extenuating circumstances, such as Company A and Company B, reports have been made to the Legislature, from time to time, by ministers of the respective departments involved.*

Recommendation

The Department should establish a system that will highlight when a major milestone is reached so that appropriate action can be taken.

Response

- *Although not currently provided for in the Procedures Manual, insurance files are reviewed on a periodic basis to ensure that policies are still in effect. This will be formalized in the Procedures Manual. While there may be periodic delays with respect to the receipt of insurance documentation, this monitoring requirement is now up to date.*

- *Company fiscal year ends are on file, and when noted, the companies are asked to provide information as required for monitoring and annual review purposes.*

- *Financial statements for one of the companies reviewed were always provided on a timely basis. The statements for the company's fiscal year ended January 31, 1999 were on file at the time of your review. Provision of the January 31, 2000 statements was deferred at the request of the company as it was in the process of restructuring its banking arrangements. This restructuring subsequently resulted in the Province being released from its guarantee.*

Findings - Other Issues

"Four recipients of loan guarantees have also received loans and/or equity financing from the Department of Development and Rural Renewal. The provision of multiple forms of assistance increases the Province's total exposure in cases of default."

- *The type of financing can vary depending on the program being accessed (i.e. term versus operating financing). However, there is nothing to preclude an applicant from accessing more that one financial assistance program, provided the criteria of each is met.*

- *Each department is generally aware of the other's involvement and consultation does occur, where necessary. The financing request is considered separately by each department and on its own merit.*