GOVERNMENT'S INVOLVEMENT WITH NATURAL ORGANIC FOOD GROUP PEI INC.
AUDIT REPORT
SEPTEMBER 2008

PREPARED BY
OFFICE OF THE AUDITOR GENERAL

Honourable Robert Ghiz
President of Executive Council
Province of Prince Edward Island

Pursuant to Order in Council EC2007-739, I present my report on Government's Involvement with Natural Organic Food Group PEI Inc.

Respectfully submitted,

Colin Younker, CA
Auditor General

Charlottetown
Prince Edward Island
November 3, 2008

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1. INTRODUCTION

1.1 Executive Council issued an Order in Council on December 12, 2007 requesting the Auditor General to carry out a special investigation into the financial relationship and transactions between the Province, Natural Organic Food Group PEI Inc. and the related company, Natural Organic Food Group Inc. (Quebec). Under section 14(d) of the Audit Act, the Auditor General shall undertake special assignments or investigations at the request of the Lieutenant Governor in Council.

1.2 Executive Council also directed the PEI Lending Agency to appoint a receiver and to prepare for the possible winding down of the hog plant over a three-month period. On January 11, 2008 the PEI Lending Agency demanded payment of the loan outstanding from NOFG PEI Inc., which at that time amounted to $2,091,000. A claim was filed with the court and the PEI Lending Agency requested the court to appoint a receiver. On January 21, 2008 the court appointed a receiver and manager of the property, assets and undertaking of Natural Organic Food Group PEI Inc.

1.3 Natural Organic Food Group PEI Inc. (NOFG PEI) is a private company and therefore, not directly subject to audit by the Auditor General. However, the PEI Lending Agency did provide working capital loans during the period of operation of the company and the Department of Agriculture provided grants of approximately $2 million. In addition, Island Investment Development Inc. administers the Provincial Nominee Program, an immigration investment program under which funds were accessed.

1.4 We did not conduct a financial audit on the books and records of NOFG PEI. We did, however, examine financial records related to terms and conditions attached to financial assistance provided by government.

1.5 Throughout our review we received cooperation from senior management of the PEI Lending Agency, the Department of Agriculture and PEI Business Development Inc. We would also like to acknowledge the assistance and cooperation of the Receiver.

2. OVERALL COMMENTS

2.1 The PEI hog plant has closed and the building and equipment have been sold. The total loss to government as a result of its involvement with NOFG PEI amounted to approximately $4 million. In this report we present findings and recommendations related to government's management of this file during the period of operation by NOFG PEI. Our review disclosed a number of issues both during the acquisition process and the period in which NOFG PEI operated the plant.

2.2 The funding sources and financing requirements identified in the original business plan for NOFG PEI were significantly changed as a result of negotiations that led to the final Purchase and Sale Agreement.

2.3 The need for significant capital upgrades to the plant in order to meet plant inspection regulations and to improve the efficiency in the kill line was considered critical to the success of the operation but the requirement for capital financing was waived. The final Purchase and Sale Agreement also resulted in increased working capital requirements, including an increase in the price of hogs. A plan was not put in place at that time to address the impact of these changes. This issue, combined with a history of losses at the plant, and a business plan that called for increased marketing expenditures and a transition period to achieve higher margin products contributed to ongoing working capital shortages at the plant.

2.4 During the period of plant operations, Government provided approximately $5 million in financing for the plant. Immigrant investor funds provided an additional contribution of $364,000.

2.5 There was a lack of coordination by government in providing assistance and monitoring the progress of this project. The PEI Lending Agency provided some financing to the project but the Department of Agriculture was the lead on the file even though assisting and monitoring of a manufacturing and processing operation was not considered within its mandate.

2.6 Monitoring of the project was further impacted by the fact that accounting records were not maintained on an ongoing basis and reliable financial reports were not produced. The state of the accounting records also prevented us from reporting with audit level assurance on the nature and amount of financial transactions between NOFG PEI and various related parties. This information is directly connected to one of the covenants in the working capital loan and also has a bearing on the collection of amounts due from related parties on receivership.

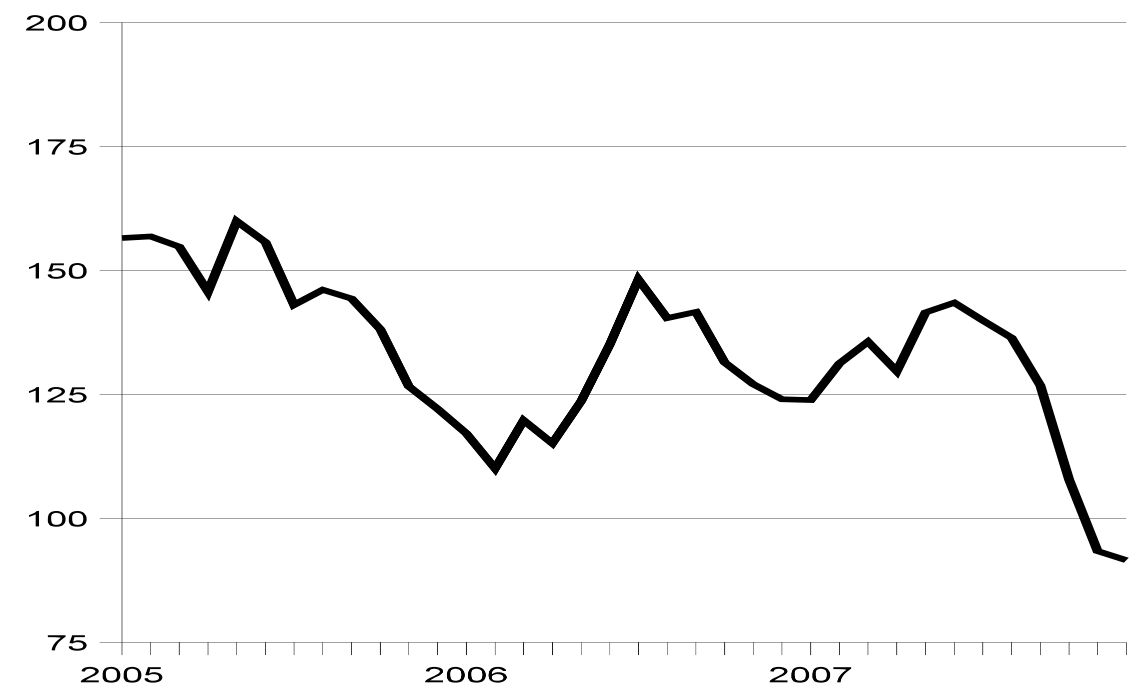
3. BACKGROUND

Industry

3.1 The Prince Edward Island hog industry consists of approximately 130 family-owned farms. The total hog inventory in January 2007 was estimated at 123,500 for PEI. This represented 38 percent of the total Maritime inventory of 322,000 hogs. These figures place PEI with the highest hog inventory in the Maritimes with New Brunswick holding 33 percent and Nova Scotia 29 percent. To put these figures in perspective for the country, the Maritimes held 2.16 percent of the total Canadian inventory of hogs with PEI representing 0.83 percent of the Canadian total. Hog receipts in Prince Edward Island were $27,538,000, $23,630,000 and $20,860,000 respectively for the years 2005 to 2007 which represent 7.5 percent, 6.3 percent, and 5.7 percent of the total agriculture cash receipts for the Province. Hog receipts decreased from 2005 to 2007 by over $6.6 million or 24 percent.

3.2 The market price for hogs is established based on the interrelationship of many factors in a volatile market. Hogs in this region are priced using a formula established on the Chicago Mercantile Exchange (CME) which is based in US dollars. The rise in the Canadian dollar has affected the net price per hog received by the farmer. During the period of operation of the Charlottetown plant by NOFG PEI, some of the lowest market prices for hogs in recent years were experienced. **Exhibit 3.1** illustrates the monthly price paid to PEI producers based on the constructed CME price converted to Canadian weights and currency. When NOFG PEI was established the hog producers were being paid CME minus $2. Over the period of operation by NOFG PEI, the prices paid to hog producers were increased to the adjusted CME pursuant to the Purchase and Sale Agreement.

EXHIBIT 3.1
PEI BASE HOG PRICES
BEFORE ADJUSTMENTS
PRICE PER CKG



per dressed carcass @ 100 Index

Source - PEI Department of Agriculture

3.3 The Charlottetown hog plant was one of three federally inspected plants in the Maritimes. The other two plants are located in Nova Scotia. According to a consultant's report commissioned by the Department of Agriculture, all three plants were operating well below capacity during 2007: NOFG PEI was estimated to have been working at between 60-86 percent of their 5,000 head per week capacity during 2007. One Nova Scotia plant with a capacity of 6,500 operated at 33-46 percent, and the other Nova Scotia plant with a capacity of 400 head per week operated at 38-75 percent capacity.

3.4 The Charlottetown plant had a single shift capacity of 5,000 hogs per week and at the time of its sale to NOFG approximately 4,000 hogs were being slaughtered per week. These carcasses were broken down into mainly primal cuts for further processing.

The plant also produced a fresh sausage line with several varieties. Although the plant had not been processing beef since 2003, it had the capacity for approximately 200 beef carcasses per week as well. The Charlottetown processing plant was over 20 years old and at the time of its sale was in need of considerable equipment upgrading to improve product quality and consistency.

4. OBJECTIVES AND SCOPE

4.1 In accordance with Section 14(d) of the Audit Act we conducted a review of the financial support provided by government to NOFG PEI. Our objective was to assess the management processes in place over the provision of assistance, the monitoring of the terms and conditions of the assistance, and the action taken to realize on the security.

4.2 In order to obtain an understanding of the industry and the environment in which the plant was operating we reviewed various industry studies, obtained industry statistics, and interviewed personnel from the Department of Agriculture, PEI Lending Agency, PEI Business Development Inc., representatives of the Producer Association, the Canadian Food Inspection Agency, as well as several shareholders, and various senior management. We reviewed documentation supporting the initial purchase of the plant, as well as each type of financial assistance provided by the Province. We reviewed consultants' studies provided to government. In addition, we reviewed the Receiver's reports and estimated the loss to government as a result of the project.

4.3 There was no financial statement audit carried out in the period during which NOFG PEI was operational and we did not complete a financial statement audit on NOFG PEI. However, we did review documents on file at the plant primarily related to cash and bank records as well as intercompany transactions.

4.4 Our examination was performed in accordance with the assurance standards encompassing value for money as established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

5. PURCHASE OF THE PLANT

5.1 On April 28, 2006 the former owner sold its 51 percent equity interest in the Garden Province Meats Plant (GPM) for $1 to the other shareholders in the plant representing hog producers and beef producers. After this transfer of shares the hog producers association owned 80 percent and the beef producers association owned 20 percent of the shares of the plant. At that time these shareholders, along with the provincial government, had determined that it was in their collective best interest to have the GPM plant continue to process hogs as the hog production sector was integral to the continued success of PEI's agricultural economy.

5.2 The Hog Commodity Marketing Board established a Transition Team to seek expressions of interest to manage and/or invest in the GPM plant. The team consisted of two deputy ministers and a financial consultant.

5.3 A Request for Expressions of Interest (REI) was issued and widely distributed. The objective of the REI was to enter into a contract with an entity to carry out the day to day operations of the plant. In addition to achieving a contract with an organization willing to operate the facility, the Transition Team indicated they would also be interested in identifying an organization which would be interested in making an equity investment in the plant.

5.4 Four submissions were received and reviewed. The Transition Team then recommended moving to a formal Request for Proposals (RFP) with two of the proponents invited to submit proposals. Only one of the two selected actually submitted a proposal. The recommendation of the Transition Team was to pursue this proposal and to follow a process of due diligence and negotiation. The Hog Commodity Marking Board established a Negotiating Committee, including members of the hog producers association with the assistance of the financial consultant involved in the Transition Team.

The Successful Proposal

5.5 The successful proposal was received from a company based in Quebec in partnership with a company directed by four Island hog producers. The direction of the original business plan was to develop differentiated pork products, including omega, natural and organic and develop the markets for these products. The plan was predicated on the projected growth in the market for differentiated food products. At that time the Quebec group had experience and knowledge in brand development and had labels and registered brands that could be used for PEI pork. A key element of the business plan was that the Quebec shareholders would provide the marketing program to place this pork into the optimal retail venues.

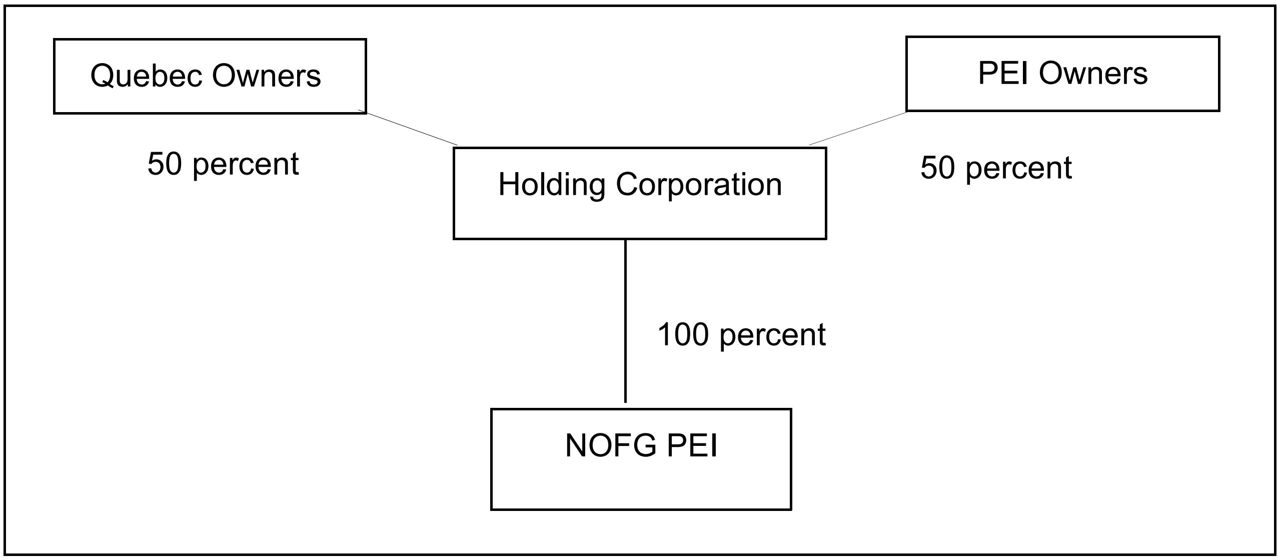
5.6 A positive aspect of the PEI Industry was that the quality of the breeding stock was high. The environment was relatively closed and with foresight the industry had controlled imports of breeding stock and semen. A minimal disease program was established several decades ago which consisted of a nucleus purebred breeding herd and a number of multiplier breeders who generated the high health pigs that improved the industry's rate of performance and substantially reduced the use of medications. This made PEI a good fit to move toward a differentiated product.

5.7 The PEI group had farm level knowledge and the producer network to motivate PEI and other Maritime farmers to produce differentiated pork. The key to a differentiated model is the traceability of the product line and on-farm adherence to specified production protocols. With experience through their involvement in specified pathogen free breeding stock, it was felt they could extend this to producers of differentiated pork.

5.8 The RFP information document included a section which identified plant upgrades that were critical to the viability of the plant. Some were related to quality improvements that were necessary to increase the availability of quality product for higher margin markets. The second were upgrades required to maintain licenses under the Canada Food Inspection Agency and the United States Department of Agriculture. The business plan proposed included taking an ownership position in the plant and carrying out the capital improvements to achieve the upgrades indicated in the RFP.

5.9 The ownership structure for the project was established by the PEI group and the Quebec group forming a holding company in which they were equal partners, each owning one share. The holding company purchased the shares of Garden Province Meats Inc. from the previous shareholders. The corporation that was Garden Province Meats then obtained a change of name to NOFG PEI. **Exhibit 5.1** illustrates the ownership structure of NOFG PEI.

EXHIBIT 5.1
OWNERSHIP STRUCTURE - NOFG PEI



Due Diligence

5.10 Although the sale of the plant was carried out between the companies owned by producer organizations and the interested purchaser was a private corporation, government was intricately involved. Government had outstanding loans to producers which at that time were in excess of $7 million. The consensus was that the future viability of the hog industry in PEI was reliant on the continued operation of the hog plant. In addition, it was understood that the proponents for the purchase of the plant would be seeking financial support from government.

5.11 We expected the due diligence carried out on the request for assistance to include, among other things, a consideration of the following factors: an evaluation of the business plan, a review of the management ability of the proponents, an assessment of the risks and any mitigating factors, a financial assessment of the company and proponents, and an evaluation of available security.

5.12 We found that government, through the Transition Team and the subsequent involvement of the PEI Lending Agency addressed many of the issues required in a project evaluation. The education and experience of management were considered. The proposed marketing plans and strategies were examined and marketing staff at PEI Business Development Inc. were requested to provide assurance the marketing approach was reasonable. Credit checks were carried out on the proponents, and security for requested working capital assistance was evaluated.

5.13 The business plan provided was based on the creation of a niche market for omega, natural and organic pork. The business plan indicated that there was a potentially large market for these products which could attract higher returns in the marketplace than commodity products. The Prince Edward Island plant was having difficulty competing with large plants supplying the commodity market. The development of these products was viewed by many in the industry as the only viable option for a small processing plant.

5.14 Producers accepted this model and in general agreed to begin to take steps which would result in changes to on-farm protocols to allow hogs produced on PEI to achieve the status of omega, natural and organic. This change in production requirements would take a period of time with omega being the shortest at six weeks to organic production of hogs which could take up to 3-5 years. The business model put forward was a three-pronged approach including:

- extensive work with hog producers to develop protocols, encourage and support the conversion of on-farm practices, and achieve production of increasing numbers of omega, natural and organic hogs;
- extensive work in market development and brand identification to develop markets for PEI omega, natural and organic pork products as well as continued work in value added product development for this differentiated pork; and
- plant and production upgrades to increase efficiency and convert to increased omega, natural and organic production.

5.15 The long-term goal of the business plan was to eventually construct a value added processing facility which would further process this differentiated pork into omega, natural and organic consumer products.

5.16 The GPM plant had been operating for 20 years and had experienced losses. The plant itself was 20 years old and at the time of the RFP, there were outstanding compliance issues with the Canadian Food Inspection Agency (CFIA) and the US Department of Agriculture (USDA) regulations which would require substantial capital investment to address. This, in addition to capital improvements needed to increase operational efficiency, was estimated to require $2.8 million in capital upgrades.

5.17 The business plan anticipated the capital requirements to be met through a $1 million forgivable loan provided by government with a $1.1 million term loan from Farm Credit Corporation and an equity investment of $700,000 from the proponents. These sources of capital financing did not materialize.

5.18 Similarly the business plan called for an increase in marketing costs to the extent of $2 million per year to develop brand identification and market opportunities for the differentiated products. These would be largely funded through incentive grants to be provided through provincial or federal programs. These additional operating incentives were not received.

5.19 **Exhibit 5.2** illustrates the planned sources and uses of funds for capital and operating improvements in the business plan.

EXHIBIT 5.2
SOURCES AND USES OF FUNDS
NEW INITIATIVES IN THE BUSINESS PLAN
(Millions)

Use of Funds-Capital		**Source of Funds - Capital**	
Equipment and plant renovations	$2.8	Equity Investment	.7
		FCC Loan	1.1
		PEI Forgivable Loan	1.0
			$2.8
Use of Funds-Operations		**Source of Funds-Operations**	
Market Development	$2.0	Innovative and development tax credit or similar provincial or federal program	$1.7

5.20 We found that as negotiations on the agreement of purchase and sale were carried out, key aspects of the financial requirements of the project changed from what was included in the original business plan provided in response to the Request for Proposals.

These critical changes in the anticipated sources and uses of funds were not given adequate attention prior to approval of the project.

5.21 There was an extensive negotiation process and a Purchase and Sale Agreement was settled on September 27, 2006 with an amendment on October 2, 2006. The final Purchase and Sale Agreement was significantly different from the business plan submitted and is illustrated in **Exhibit 5.3**.

EXHIBIT 5.3
COMPARISON OF THE BUSINESS PLAN AND THE TERMS OF NEGOTIATED PURCHASE

	Business Plan			Purchase and Sale Agreement	
	Capital			Capital	
•	Capital Improvements Required	$2.8 million	•	Requirement for Capital Financing Waived	
	Effect on Working Capital			Effect on Working Capital	
•	Share price	$1	•	Share price - cash	$200,000
				Return on equity $1.53 x 200,000 estimated hog throughput (year 1 of 3 year commitment)	$306,000
•	Hog Price: Maintain hog price at previous operators price CME less $2	$0	•	Hog Price: Stepped increase to CME x 200,000 estimated throughput (year 1)	$267,000
•	Maintain producer payments at one week after delivery	$0	•	Producer payments same week as delivery (one time)	$650,000

5.22 As can be seen from the Exhibit, the Purchase and Sale Agreement that was negotiated reflected a significant change in capital funding and working capital requirements. There was no plan put in place to address the impact of these changes.

Capital Financing

5.23 An initial risk facing the project related to lack of financing in place at the outset. The need for capital upgrades was noted in the RFP. The proponents indicated the need for $2.8 million to complete the capital upgrades. When the capital was not in place at the time of completion of the agreement of purchase and sale, Government waived this as a requirement on the assurances that the proponents would continue to seek external financing.

5.24 At that time the Department of Agriculture indicated that it was essential the capital financing be acquired and without the investment in the short or medium term the plant would not be successful. They also noted that the capital financing was not likely to be available until the plant operations could be turned around. It was likely the Province would be approached to provide the required financing in six to eight months and personal guarantees of the proponents were taken in anticipation of the requirement to provide future financing.

5.25 Although the PEI Lending Agency Board approved the full capital financial plan on September 22, 2006 and the Department of Agriculture indicated that the financing would probably be required from government sources, the capital financing was not put in place. The requirement for the proponents to have capital financing in place prior to the close was waived by Executive Council on assurances that the proponents would seek external financing. The effect was that the company was under capitalized. They could not achieve the working capital projected because of poor quality cuts. They could not achieve the operational efficiency because of needed capital upgrades. In addition, there were outstanding compliance issues with CFIA and USDA. This impacted their ability to raise external financing for the expansion to value added processing.

Operational Financing

5.26 The Purchase and Sale Agreement provided for the purchase of shares of the plant in exchange for $200,000 in cash, $100,000 of which was provided to beef producers for the shares held by their association. In exchange for an exclusive three-year supply agreement the purchasers agreed to pay to producers a premium for hogs delivered to the plant. This premium was based on $1.1 million less an adjusted modified net zero calculation as of September 29, 2006. The modified net zero calculation was provided by an arms length third party. This net equity would be paid back to producers on a per hog basis at 40 percent in the first year, 30 percent in the second year and 30 percent in the third year. This premium per hog amounted to $1.53 per hog during the time of the operations of NOFG PEI.

5.27 In addition to this premium, the hog producers required and obtained a change in the pricing strategy. Under the previous ownership the plant paid a price per hog which was the constructed Chicago Mercantile Exchange (CME) rate less $2 per hundred kilograms. The supply agreement was negotiated as follows: for the first three months the price would remain the same, during the fourth and fifth months it would be adjusted to CME less $1, thereafter it would be CME. In addition, the agreement provided for the hog producers to be paid weekly for hog deliveries in the current week rather than on the week following deliveries.

5.28 The purchase of shares, return of net equity to producers, and the price adjustment resulted in additional working capital requirements of the plant of approximately $770,000 in the first year. Estimates prepared for the Department of Agriculture indicated that the adjustment to the timing of the hog payments resulted in a one time drain on working capital of $600,000-$700,000. These additional working capital needs along with the increased projected expenditures in marketing of $2 million per year meant an increase in working capital requirements of approximately $3.4 million. The project did not receive the working capital as required which meant it was operationally underfunded.

5.29 Given the risk of NOFG's inability to obtain financing and the acknowledged probability that government would be again approached by the company for capital assistance, government should have monitored the progress of the corporation in seeking external financing. In addition, given these known significant estimated increased operational requirements, government, as part of the due diligence should have worked with the corporation to determine how it would meet its operational financing needs up to the point where increased margins from the differentiated products were expected to be realized.

Recommendation

5.30 When government enters into a development project it should ensure that a financial plan is in place to address the financing requirements and sources of funding. Financing risks identified should be monitored.

6. GOVERNMENT FINANCIAL SUPPORT

6.1 NOFG PEI took ownership of the plant in October 2006. Over the 15 months during which NOFG PEI operated the plant, government provided financial assistance through several sources as illustrated in **Exhibit 6.1**.

EXHIBIT 6.1
GOVERNMENT ASSISTANCE TO NOFG PEI INC.
October 2006 to January 2008
($000)

PEI Lending Agency	**Actual**	**Approved**
Working Capital Line of Credit	$1,475	$1,500
Extension #1	350	350
Extension #2	250	250
	$2,075	$2,100
Department of Agriculture		
Working Capital Grants	$1,775	$1,800
Equipment Grants	172	198
Honoring of Guarantee to Producers		
• initial 2 week guarantee payout	729	1,000
• additional weeks pay out	197	-
	$2,873	$2,998
Total	**$4,948**	**$5,098**

Note: Does not include amounts flowed through to producers under the Swine Quality Improvement Program.

PEI Lending Agency - Working Capital $1.5 Million

6.2 On September 21, 2006 a conditional letter of offer was issued to Garden Province Meats (which later became NOFG PEI). The offer included a revolving line of credit of $1.5 million and a guarantee to producers that the Province would provide payment to a maximum of two weeks regular shipments in the event of default by GPM. There were numerous conditions attached to the financing offer:

- the execution of a purchase and sale agreement;
- the provision of a supply agreement by the Hog Marketing Board;
- confirmation of $500,000 cash injection by proponents;
- confirmation of $2.8 million in capital financing;
- security for the line of credit to be a first charge on accounts receivable and inventory and a second charge on plant assets;
- PEI to have the right of first refusal on the value added processing capacity being considered; and
- while the line of credit and bond were outstanding a number of requirements would be in place to limit the action the company could take without the written approval of the PEI Lending Agency.

6.3 The final letter of offer was signed on October 5, 2006 with an amendment on October 10, 2006, and some conditions were altered from the September 21, 2006 conditional offer. Executive Council waived the condition for capital financing to be in place. The PEI Lending Agency was directed to provide a working capital loan of $1.5 million and a guarantee of payment of two weeks shipments to producers up to $1 million.

Department of Agriculture Grant - $398,000

6.4 On May 4, 2007 a request for assistance was received from NOFG PEI by the Department of Agriculture. The plant was due to be audited for compliance with the United States Department of Agriculture regulations which were required in order to maintain its export license. The company needed to demonstrate a commitment to remediate deficiencies noted in the previous USDA/CFIA audit. The company had tried to obtain the required capital financing but was unsuccessful. A memorandum of understanding (MOU) was issued by the PEI Department of Agriculture for $99,000 related to implementation of Biosecurity measures with terms and conditions set out. The

USDA/CFIA audit was conducted on May 24, 2007 and resulted in a Notice to Delist the Facility and revoke the Export license.

6.5 In June 2007 the $1.5 million line of credit provided by PEI Lending was fully drawn down and the plant was in need of additional working capital. A commitment to provide working capital financing had been received from a financial institution if the Province would provide the capital financing. In response to a recommendation from the Department of Agriculture, Executive Council approved $200,000 in working capital to enable the plant to continue operating pending further consideration by the new government. On this same date, a further MOU for additional funding to address the USDA/CFIA audit requirements was signed in the amount of $99,000.

6.6 The two MOUs totaling $198,000 were for the same list of required equipment and upgrades in order to maintain the USDA/CFIA certification. These agreements were divided in two and each approved by the Deputy Minister of Agriculture. The Treasury Board Policy on Delegation of Signing Authority requires Treasury Board approval for contracts exceeding $100,000.

6.7 An accounting firm was engaged in June 2007 to carry out a review and make recommendations on the one month and six month cashflow requirements of the facility, the cash required to implement the planned operational and capital improvements required to remediate the deficiencies identified in the USDA/CFIA audit, and to analyze the disposition of the funds advanced by shareholders and the PEI Lending Agency.

6.8 Under the terms of the MOUs, $50,000 was advanced on signing the first MOU and invoices were to be obtained before additional funding was provided. We found there was approximately $80,000 worth of payments made which did not have the support of an invoice. These payments were made based on quotes and estimates. This represents approximately 50 percent of the total paid under both MOUs.

Department of Agriculture Grant - $1.6 Million

6.9 On July 4, 2007 the Department of Agriculture provided information to Executive Council regarding the financial condition of the plant and the need for additional working capital. The company was requesting working capital to continue to operate and to increase throughput to achieve greater efficiency at the plant. Executive Council approval was obtained for the Department of Agriculture to provide working capital grants to a total of $1.6 million which was designed to allow the plant to continue to operate at current levels. It was anticipated that this infusion of working capital would cover the plant for three months.

6.10 The Department continued to engage an accounting firm to review the cash flow requirements and provide approval on the weekly request for working capital advances.

6.11 We noted that the Executive Council approval stated that the PEI Lending Agency and the Deputy Minister's Working Group on the Beef Plant would be responsible for setting conditions on the disbursement of the funds and approve and track the payments. When we followed up with the PEI Lending Agency we were advised they were not aware of their intended role in this scenario. Although the Department of Agriculture implemented a process whereby an external accounting firm provided oversight for the advance of working capital under the $1.6 million grant, the working group did not establish documented conditions for the disbursement of funds.

PEI Lending Agency - $350,000

6.12 In October 2007 the working capital loan of $1.5 million from PEI Lending Agency was due for renewal. The financial condition of the plant had not improved and the efforts to raise external investment capital in order to address the critical plant upgrades were ongoing. Because of the condition of the plant and the working capital shortage, it was difficult to interest external financiers until the owners could prove the business model would work. The PEI Lending Agency renewed the working capital loan for an additional year and provided an increase to the working capital loan of $350,000 on the approval of the Board of Directors. This additional funding was provided with a guarantee by the Department of Agriculture that if NOFG PEI could not repay the loan, the Department would cover the loss to the PEI Lending Agency.

6.13 PEI Lending Agency Act Regulations Section 2(1) states that *The Agency may, with the approval of the Board, advance any loan to any person where the total indebtedness of the person, including guarantees provided on behalf of that person or affiliate does not exceed $2,500,000 in the aggregate. Section 2(2) requires Executive Council approval for loans in excess of $2,500,000 in aggregate.*

6.14 The original letter of offer to NOFG PEI by PEI Lending Agency provided for a $1.5 million working capital loan and a guarantee of up to $1 million. These total $2.5 million in exposure to this client. Therefore, the additional working capital of $350,000 should have been approved by Executive Council.

PEI Lending Agency - $250,000

6.15 In December 2007 the plant was struggling to meet producer payments and a further increase to the working capital loan was approved for $250,000. This again was provided by the PEI Lending Agency with a letter of guarantee from the Department of Agriculture. In this case the additional financing was approved by the CEO of the Lending Agency with the intention of receiving ratification by the Board of Directors at the next Board meeting. Before the next PEI Lending Agency Board meeting was held, the government announced they were no longer supporting the plant. This additional working capital was never ratified by the Board of PEI Lending Agency and was not approved by Executive Council.

6.16 Although the Department of Agriculture provided a letter of guarantee to PEI Lending Agency, the total exposure exceeded the $2.5 million approved in the original letter of offer. These two additional loans amounted to $600,000 bringing the exposure through loans and guarantees to $3.1 million.

Recommendations

6.17 Financial assistance provided by the PEI Lending Agency should be approved in accordance with the Lending Agency Act Regulations.

6.18 Invoices should be obtained prior to advancing funds for equipment acquisition.

6.19 Responsibilities outlined by Executive Council regarding the disbursement of financial assistance should be followed.

7. COMPLIANCE WITH TERMS AND CONDITIONS OF FINANCIAL SUPPORT

7.1 Financial assistance provided by government normally includes terms and conditions to ensure the recipient uses the assistance for the purposes intended and to reduce the risk to public funds. We expected the PEI Lending Agency and the Department of Agriculture to impose terms and conditions on the financial assistance they provided and to monitor compliance with those conditions. Our audit procedures included an assessment of compliance with the terms and conditions agreed to by NOFG PEI and government.

PEI Lending Agency

7.2 The loan agreement included security and other conditions which had to be met prior to the closing of the transaction, specific negative covenants which were to be complied with during the time the loan was outstanding, as well as specific reporting requirements during the period of the loan agreement.

Security Requirements

7.3 The security required in the letter of offer included:

- a promissory note for $1.5 million;
- a general security agreement of $2.5 million;
- a first security interest over all inventory and accounts receivable and a second security interest over personal and real property of the borrower including land, buildings and equipment which on or before December 31, 2006 shall become a first security interest;
- a $2.5 million corporate guarantee from each of the Quebec company, the PEI company and the holding company;
- personal guarantees of five proponents in the amount of $50,000 each; and
- fire insurance coverage.

All of these security requirements were in place prior to release of the working capital loan.

Negative Covenants

7.4 The loan agreement included specific negative covenants to limit the action the borrower could take without the written consent of the Agency. One of these covenants stated that the borrower would not permit outflows of funds to an affiliate or related company, their shareholders or directors. This would include but was not limited to redemption of shares, payment of dividends, extension of loans or similar outflows. The agreement states that consideration for payment of dividends and bonuses would be given by the Lending Agency upon satisfactory review of the financial statements. We carried out various audit procedures to assess compliance with this covenant.

7.5 At the outset of our audit work we noted that the financial records of NOFG PEI included accounts receivable from related companies with general ledger balances as indicated in **Exhibit 7.1**. We attempted to substantiate the balances in these intercompany accounts to determine the amount and nature of any outflows to related parties. Due to the incomplete financial records we cannot provide an audit level of assurance that the account balances are correct. For example, we became aware that NOFG PEI had entered into a contract with the PEI owners whereby an amount would be paid for each omega, natural and organic hog purchased by the plant. In addition, $1 per hog would be paid for specific services provided. We found that due to the financial pressures at NOFG PEI payments to the PEI owners ceased and the remaining amounts payable were not recorded in the financial records. There was no record of this contract at the plant and we only became aware of it during interviews. There could be other contracts in place that were not reflected in the accounting records.

EXHIBIT 7.1
GENERAL LEDGER BALANCES
INTERCOMPANY LOANS
AS AT JANUARY 2008
(unaudited)

Accounts Receivable by NOFG PEI from:	
Quebec Company - owners	$(306,339)
PEI Company - owners	(16,903)
Holding Company	499,541
Consultant Company owned by a shareholder	336,190
	$ 512,489

7.6 Given the condition of the accounting records, we then began reviewing the bank statements of the Company to gain an understanding of its cash flows. We were particularly focused on those transactions that may violate the covenants in the agreement.

7.7 In our review of cash transactions, we focused on payments to related parties, to Quebec vendors, and to other non-operational vendors. We conducted an extensive review of cash transactions. We reviewed the cheque listings of all bank accounts to identify payments made to selected vendors and examined supporting documentation where available. To ensure our review of payments was complete, we also reviewed all non-cheque withdrawals, such as wire transfers from each bank account. Again, we looked for backup to substantiate those transactions. Finally, we looked for backup supporting the deposits into each of the bank accounts.

7.8 We focused our review on the cash transactions as we had concluded the accounting records of the Company were largely unreliable. The accounting records of the company had never been audited, the position of controller had been vacant for months, bank reconciliations had not been done for an extended period, and many adjusting entries had no supporting backup available for review. The fact that there were no accounting personnel on site made our review that much more difficult.

7.9 As a result of our work on cash transactions, we found that bonuses were paid in the amount of $10,000 to each of the Vice President of Finance and the President of NOFG PEI without the approval of PEI Lending Agency. This is a specific contravention of the terms of the loan agreement.

7.10 Although we could not substantiate intercompany balances, we noted several instances where transfers were made from NOFG PEI to related companies that require further comment. During the operation of NOFG PEI wire transfers of $240,000 were made directly to the loan account of the Quebec company. These amounts reduced the outstanding payable to the Quebec company. The payable to the Quebec company arose mainly as a result of a branding and marketing agreement which was in the normal course of business.

7.11 There was an amount of $336,000 paid by NOFG PEI to a consulting company owned by the President of NOFG PEI. This amount was set up as an advance to the consulting company that was receivable to NOFG PEI. This loan to a related party does not appear to be in the normal course of business operations and should therefore have been approved in advance by the PEI Lending Agency under the terms of the loan agreement.

7.12 The numbered company acted as a holding company on behalf of the Quebec owners and the PEI owners. There was an amount of $345,000 advanced to the holding company which was used by the holding company to acquire the hog plant including payment for the shares and legal fees. PEI Lending Agency was not specifically requested to approve this advance to a related company. However, it appears that government was aware that the funds would be used in this manner.

7.13 Most of the Senior Management of NOFG PEI were located in Quebec during its period of operation. Although efforts were made to hire a local controller, a suitable candidate was not found. Management personnel were paid a combination of salary, bonuses, and consulting fees in some cases. In addition, management was reimbursed for travel costs. These reimbursements would not include payments made directly by NOFG PEI to travel vendors. As part of our work we examined all payments for travel, salary and consulting fees paid to these personnel. In total these payments were significant. For some travel and consulting fee transactions we could not obtain supporting documentation. **Exhibit 7.2** illustrates the compensation to four senior management personnel broken down by type of payment.

EXHIBIT 7.2
PAYMENTS TO NON RESIDENT SENIOR MANAGEMENT OF NOFG PEI
FOR THE 16 MONTHS ENDED JANUARY 30, 2008
($000)

Salary	$ 442
Bonus	20
Consulting Fees	234
Travel Reimbursements	348
Total	**$1,044**

7.14 The operation of a kill and chill facility requires extensive working capital. Large amounts of cash are required to purchase hogs on a weekly basis. To the extent that the cash raised in PEI either through the working capital loan or through normal turnover of accounts receivable was transferred to other affiliated organizations, it was not available for operations. These intercompany transactions affected the cash flows of an already cash strapped company to the point where it increased the requirement for assistance from Government.

Financial Reporting

7.15 The loan agreement with the PEI Lending Agency set out a number of reporting requirements. NOFG PEI was to provide to Lending, within 15 days of the end of each month, the monthly interim financial statements including an income statement, balance sheet, aged listing of payables and receivables, margin calculation and summary of inventory. A copy of the audited financial statements was to be provided 120 days after the fiscal year end.

7.16 The Lending Agency did not receive any interim financial statements during the period when the loan was outstanding. When the former owners of the plant left, the accounting system was dismantled. A contract for a new system had been entered into and was required to be honored by NOFG PEI pursuant to the agreement of purchase and sale. This new system required complete set up and a rebuild of accounts from April 2006 to the date they took possession in October 2006. Just after NOFG PEI took ownership of the plant, the controller resigned. This meant the company was faced with limited financial experience and a new system that needed to be implemented.

7.17 Management of the plant tried to hire a new controller and engaged the assistance of a Human Resource group but was not successful. The company obtained accounting assistance from local firms and worked to set up the financial accounting system. Under these conditions the regular monthly financial statements were not produced until the spring of 2007.

7.18 Audited financial statements were not produced. The year end for the NOFG PEI plant was September 30. The first year end therefore was September 2007 with closing entries prepared in October. By that time the plant was in severe financial difficulty and no audit was carried out.

7.19 The PEI Lending Agency did receive a margin statement each month signed by the Company President and the Vice President of Finance. The margin statement included a statement of the accounts receivable balance and the inventory balance as well as a calculation of the loan based on the percentage of outstanding accounts receivable and inventory. These statements were late seven out of twelve months. Due to problems with the accounting system, we could not trace the accounts receivable and inventory balances which were reported to the Lending Agency to the financial accounting records at NOFG PEI.

7.20 The letter of offer states that the working capital loan shall not exceed 75 percent of the accounts receivable balance and 50 percent of the inventory balance. We noted that the working capital loan was out of margin for three months, June, July and August of 2007. Lending Agency staff followed up as required.

7.21 Given the fact that NOFG PEI did not provide monthly financial statements during the period of operations, we considered what additional action PEI Lending Agency could have taken to monitor the loan. We noted that a contingent condition of the loan was the right for the Province to appoint a voting member to the Board of Directors of the company. This condition was not exercised.

Department of Agriculture

7.22 Similar to the loan agreement, the agreements in place over the financial assistance provided by the Department of Agriculture also included reporting requirements. The two MOUs for Biosecurity and USDA/CFIA certification required a final report and reconciliation to be provided by NOFG PEI to the Department of Agriculture. This report was not provided and there is no indication that the Department followed up with the company to obtain it.

7.23 The $200,000 grant, that was provided to the company in June 2007 to allow the plant to continue to operate until the new government had an opportunity to consider the situation at the plant, had a condition attached to the funding that all functions related to NOFG PEI currently based out of Montreal would be reassigned to Charlottetown. This condition was not followed up by the Department.

7.24 In addition to these grants, the Department of Agriculture had a Swine Quality Improvement program (SQIP) which had existed under the plant when it was operated by the former owners. This program provided a premium to hog producers if their hogs met certain quality requirements. The program was administered through the plant. Although this program acted as a flow through from the Department to producers, the total amount allowed each year was provided by the Department in advance to NOFG PEI. Two lump sum payments totalling $400,000 were made for 2007-08. If the grant exceeded the amount required to be paid out to qualified producers, then any excess was to be paid back to the Department. Although this is a flow through grant to producers, it affected the working capital available to the plant for operations. The Memorandum of Understanding for the SQIP required monthly reports on the number of qualifying hogs and the amount paid out. We found the Department was not receiving these monthly reports from NOFG PEI and did not follow up. Therefore it is not clear if all the SQIP funds received by NOFG PEI were fully disbursed to producers.

Recommendations

7.25 If required financial statements of a client company are not available, compensating controls should be implemented such as reviewing other types of reports and/or exercising a right to appoint a representative to the Board of Directors.

7.26 The Department of Agriculture should ensure that terms and conditions attached to financial assistance are complied with.

8. COORDINATION OF GOVERNMENT INVOLVEMENT

8.1 Given the impact of this project on the hog industry in PEI and the involvement of various government agencies including the Department of Agriculture, the PEI Lending Agency, and the PEI Business Development Inc., we expected the business relationship between NOFG PEI and the Government to be coordinated with clear lines of authority.

8.2 In the early stages of the development, the Transition Team was established consisting of the Deputy Minister of Agriculture, the Deputy Minister of Development and a financial consultant. Early on, the Deputy Minister of Agriculture became the lead on the file. When negotiations were well under way, the PEI Lending Agency was approached in August 2006 to act as the vehicle for the government financing that would be provided. We were advised that the PEI Lending Agency did not carry out the normal project evaluation on this file because many of the aspects had already been negotiated. Although the Lending Agency had input into the letter of offer, and the offer was approved by the Lending Agency Board of Directors, from Lending Agency's perspective they had been directed to provide the financing and had not been provided access to all aspects of the original business plan.

8.3 In October 2006 when the plant changed hands, government waived the condition for the proponents to have financing in place for the capital upgrades required at the plant. The submission to Executive Council indicated it would be unlikely the proponents would be able to raise external financing and government would be required to provide the financing within six months. The PEI Lending Agency advised they were not party to this submission although they were advised the requirement was waived. When NOFG PEI approached the Department of Agriculture in May 2007 for assistance to retain the USDA/CFIA certification, the Department was concerned that financing had not been obtained and upgrades had not been made. We were advised that the Department of Agriculture did not see their role as one of monitoring the progress of this project.

8.4 In July 2007 when the $1.6 million working capital grant from the Department of Agriculture was approved, the PEI Lending Agency had a working capital loan of $1.5 million outstanding. The Lending Agency was not party to the request for additional operating assistance for the plant put forward by the Department of Agriculture. The information provided to obtain the financing indicates NOFG PEI had obtained an offer to finance the working capital requirements of the company by an external financial institution if government would finance the capital upgrades to the plant. It does not appear that this financing offer was thoroughly assessed by government.

8.5 In June, July and August of 2007, external accounting staff were engaged by the Department of Agriculture to monitor and oversee the advancing of working capital under the $1.6 million grant approved by Executive Council. We were advised these services were purchased because it was not in the normal course of business for the

Department of Agriculture to monitor the disbursement of working capital grants to private companies. However, government has expertise and experience in this area through both PEI Lending Agency and PEI Business Development Inc.

8.6 This project was an economic development project. The plant itself had existed for 20 years and in that respect it was not new, however, the business plan to develop differentiated products and value added processing of pork was new. The proponents were trying to develop new products and new markets related to the pork industry. The adaptation of the plant to new processes and the upgrades for the kill line to improve product quality were necessary for the continued operation of the plant. Government has an economic development section with expertise and experience in economic development initiatives.

Recommendation

8.7 To ensure economic development initiatives are thoroughly assessed and monitored there should be coordination among departments and agencies keeping in mind their respective mandates and areas of expertise.

9. GUARANTEE TO PRODUCERS

9.1 The financial assistance provided by government included a surety bond of up to $1 million. The surety bond was to provide comfort to hog producers and it would guarantee to producers that sufficient funds would be available to pay for a maximum of two weeks regular shipments in the event of a default by NOFG PEI. If the PEI Lending Agency was required to pay this out, all costs would then become part of the debt owed by NOFG PEI.

9.2 The guarantee by government to producers was a requirement established early in the negotiation process for this project. The Executive Council approval included this guarantee. Although it was agreed to by all parties in the signed letter of offer, we were advised that the bond document was not prepared.

9.3 Even though there was no surety bond document drawn up, the terms and conditions of the guarantee were established in the original letter of offer which was agreed to by all parties. Therefore, the requirement to pay the amount of two weeks regular shipments up to $1 million to producers was binding.

9.4 According to the letter of offer, the Bond was subject to an annual fee of 1 percent which is the normal guarantee fee required by PEI Lending Agency. We found that this administration fee was not collected by PEI Lending Agency.

9.5 When the plant was placed into receivership in January 2008 there were a number of producers that were owed money for hog shipments. The Department of Agriculture obtained a list of outstanding amounts due to hog producers from the Receiver. On January 25, 2008 the Department paid out $729,000 in payments to producers for the two weeks of shipments prior to plant closure. A subsequent payment of $197,000 was made to producers to pay out all outstanding amounts owed to producers by the plant. This subsequent payment was not approved by Treasury Board or Executive Council.

9.6 The first payment to producers to cover the two weeks shipments was agreed to in the initial letter of offer. When the plant ceased operations government was required to honor its commitment. However, the additional $197,000 paid out to producers for additional weeks was not required under the terms of the agreements. For shipments beyond the two weeks covered by the guarantee, producers became unsecured creditors. There are a number of unsecured creditors who have sustained losses as a result of the closure of the plant. Decisions such as this to provide additional support over and above what was agreed to at the time, should only be entered into after consideration of the full context of the impact on affected parties. The original guarantee was approved at the Executive Council level and therefore, changes to that guarantee should have been made at the same level.

Recommendation

9.7 The Department of Agriculture should ensure changes to terms and conditions attached to financial assistance are authorized at the level of the original approval.

10. INVESTMENT BY PROPONENTS

10.1 The initial business plan set out a personal investment by the shareholders of $700,000 in equity. In the final loan agreement provided to the proponents this requirement was revised to a $500,000 cash injection. During negotiations there is evidence that the shareholders indicated they did not have equity to invest in the project.

10.2 In order to satisfy the cash injection requirement, the proponents applied for funding under the Provincial Nominee Program which is administered by Island Investment Development Inc., an agency of government. Under this program there is a time lag between approval of a company and the receipt of funds through investment units. Therefore, NOFG PEI entered into a mortgage as a bridge financing arrangement which was to be repaid as the immigrant investment funding was received.

10.3 The mortgage was secured by a first charge on the plant and equipment of NOFG PEI. Under the terms of the letter of offer, the Lending Agency agreed to take a second position security on the land, building and equipment. On or before December 31, 2006, the first position security held by the third party lender to secure the $500,000 mortgage was to be satisfied or postponed to the interest of the Lending Agency. If NOFG PEI could not retire the debt at December 1, 2006 then the PEI owners, the Quebec owners, and the numbered company were required to retire the debt to allow the Lending Agency to obtain first position.

10.4 There are several issues with this arrangement. The letter of offer required evidence of the shareholders' cash injection of $500,000. This amount was provided pursuant to the $500,000 mortgage but it was secured using the assets of the company being acquired, i.e., NOFG-PEI. The mortgage carried an interest rate of Bank of Canada prime rate plus 4 percent. The interest on the outstanding balance was paid by NOFG PEI with a portion set up as receivable from the Quebec owners and the numbered company. In addition, a fee of $50,000 was taken by the financing company and when the mortgage was not fully paid out by December 31, 2006 an extension fee of $57,500 was paid by NOFG PEI but was again set up as receivable from the Quebec company and the numbered company. **Exhibit 10.1** illustrates that although the loan agreement required a $500,000 cash injection by shareholders the net cash injection to NOFG-PEI was $403,900. In addition, $345,000 was advanced to the holding company to cover the purchase of shares and other costs associated with the purchase of the plant.

EXHIBIT 10.1
CASH INJECTION
REQUIRED BY LOAN AGREEMENT

Mortgage Financing		$500,000
Less: Amounts paid by NOFG PEI		
Interest on Mortgage	$38,600	
Extension Fee	57,500	(96,100)
Net Cash Injection		$403,900

10.5 The Provincial Nominee Program is a Federal/Provincial program designed to expedite immigration for individuals and their families who meet the criteria for the following initiatives:

- increased business and economic development;
- increased supply of skilled workers;
- increased population; and
- achievement of provincial demographic social and cultural objectives.

Under this program eligible immigrants invest in local companies, and in exchange the processing of their visa through Immigration Canada is expedited.

10.6 The PEI owners and NOFG PEI applied for and were approved to receive four investment units each which were applied against the mortgage. We did not audit the Provincial Nominee Program. However, we obtained and reviewed documentation on the net cash received through the program.

10.7 Government approved the use of the Provincial Nominee Program to pay out the bridge financing arranged by the shareholders. The investment units provided to the recipient company were expected to amount to approximately $55,000 each. This multiplied by eight units is $440,000 which indicates a known shortfall of $60,000 in retiring the mortgage. There was no indication of where this money was going to come from. In addition, when the units were acquired there was a commitment fee of $50,000 related to the mortgage as well as additional legal fees and settlement fees extracted from the units up front, so that NOFG PEI received less than $55,000 per unit. The loan agreement required the mortgage to be settled by December 31, 2006 to allow Lending Agency to obtain first position security. When that date arrived, NOFG PEI could not pay the balance due and the PEI Lending Agency did not receive first position security as required.

10.8 **Exhibit 10.2** illustrates the net cash received through the Provincial Nominee Program and the shortfall on settlement of the mortgage. PEI Lending Agency was required to pay out $142,000 to satisfy the mortgage. This amount was added to the outstanding debt of NOFG PEI.

EXHIBIT 10.2
NET CASH AVAILABLE
TO SATISFY MORTGAGE

Mortgage Balance		$500,000
Less:		
Provincial Nominee Receipts:		
8 Units x 55,000	$440,000	
Legal Fees	(21,400)	
Settlement Fees	(5,000)	
Commitment Fee-Mortgage	(50,000)	(363,600)
Add:		
Accrued Mortgage Interest to Date of Payment		5,600
Amount paid by PEILA		$142,000

10.9 Personal guarantees were signed by five Directors and pledged as security for the loan agreement with the PEI Lending Agency. These personal guarantees are held by the PEI Lending Agency.

10.10 As part of the required security for the $1.5 million working capital loan and the $1 million guarantee to the hog producers, corporate guarantees of $2.5 million were signed by the holding company, the Quebec company and the PEI company. For the PEI company and the holding company an additional certificate was provided stating that if the company was required to pay out the guarantee it would still have assets sufficient to meet its liabilities.

10.11 We were advised that Lending Agency will consider its action under the guarantees when the total loss to the Agency is finalized and the Receiver's final report is issued.

Recommendation

10.12 PEI Lending Agency should assess the recourse available in exercising the remaining security for the loan.

11. BRANDING AND MARKETING

11.1 It was stated in the original business plan that the Quebec company would be the marketing arm of the organization. Prior to its involvement with the PEI plant, the Quebec company was working on developing and registering a number of omega, natural and organic brands and trademarks.

11.2 On October 20, 2006 NOFG PEI signed a Trademark and Marketing Licensing Agreement with the Quebec company. This contract related to five trademarks that were developed or were under development. The contract allowed NOFG PEI to use these trademarks and related expertise of the Quebec company in exchange for $487,500 up front and a royalty of 0.5 percent of net revenues up to the first $100,000,000. In addition, NOFG PEI agreed to pay all out of pocket costs of the Quebec company. Up to the end of September 2007, there were $160,000 in royalties set up as payable to the Quebec company under this agreement.

11.3 Given that the letter of offer required written approval by the Lending Agency for cash outflows not in the normal course of business, we assessed the Trademark and Marketing Licensing Agreement to determine whether the nature and amount of payments arising from the contract were reasonable and in the ordinary course of business.

11.4 We found there was no supporting documentation to substantiate the valuation of the branding asset at $487,500. We were advised that this amount was arrived at through discussion and negotiations. We subsequently determined that this type of arrangement including a royalty fee is not unusual and the valuation arrived at is not unreasonable.

11.5 Although the branding asset was set up as an asset on the records of NOFG PEI, it would not have a liquidation value for receivership purposes as the Agreement that gave rise to the asset provides an exclusive license for use but not title to the brands developed.

12. RECEIVERSHIP

12.1 The Quebec group was working with a securities firm to raise private capital for the operation. A letter indicating that work was underway in this regard was sent to the Department of Agriculture. On December 11, 2007 Executive Council met to address a request by NOFG PEI for additional working capital assistance to continue operations until the first tranche of investment capital was anticipated, which was expected to arrive the end of January 2008. The decision was made to decline the request and direct PEI Lending Agency to move to appoint a Receiver.

12.2 On December 13, 2007 the government publicly announced that it was no longer supporting NOFG PEI. The shareholders of NOFG PEI offered the plant to government but it was not accepted. Finally on January 18, 2008 the PEI Lending Agency was notified that the plant could no longer continue to operate. On January 21, 2008 PEI Lending Agency, as the holder of the security, applied to the court to have a Receiver appointed.

12.3 The Receiver was appointed by the court on the recommendation of the PEI Lending Agency. The Receiver took control of the plant and operated as a going concern for a brief period. A request for expressions of interest to acquire the plant was issued by the Receiver and no offers were received. On the Receiver’s recommendation the plant ceased operations on March 28, 2008.

12.4 Upon closure of the plant, the Receiver took action to liquidate the land, buildings and equipment to the benefit of the secured creditor, PEI Lending Agency. Once the Receiver was appointed, the relationship between the Receiver and Government was managed through the PEI Lending Agency. As of September 30, 2008, the Receiver provided three reports based on activities carried out under the receivership. All three reports were filed with the court.

12.5 **Exhibit 12.1** illustrates the amounts paid out by government and the recoveries as a result of the receivership.

EXHIBIT 12.1
NOFG-PEI INC.
ESTIMATED LOSS TO GOVERNMENT
($000)

Government Assistance to NOFG-PEI Inc.		
PEI Lending Agency	$2,075	
Department of Agriculture	2,873	
		$4,948
Add Costs/Charges		
Accrued interest	20	
Buy out of 1st position on Mortgage (added to debt)	142	
PEI Lending Agency-Legal	81	
PEI Lending Agency-Receiver	192	
Consultant fees	198	633
		5,581
Less Estimated Recoveries		
Estimated receipts - sale of property, auction and collections	1,279	
Estimated disbursements to complete	(386)	
Cash on Hand	385	(1,278)
Estimated Total Loss to Government		**$4,303**