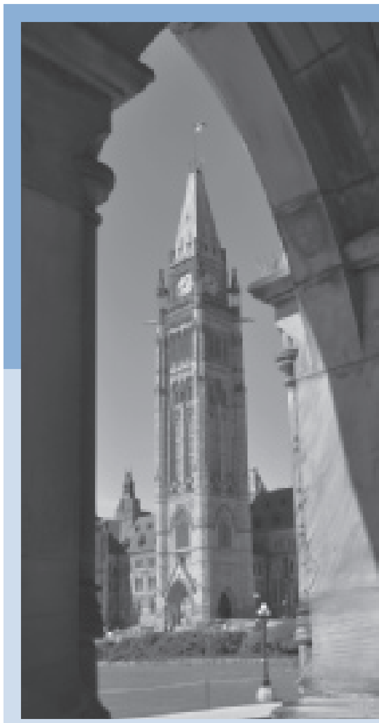
Spring 2018

Reports of the Auditor General of Canada to the Parliament of Canada

Commentary on the 2016–2018 Performance Audits of Crown Corporations

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada



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Problems affecting the management and oversight of Crown corporations

Purpose of this report

1. Between March 2016 and March 2018, the Office of the Auditor General (OAG) conducted performance audits of the management practices of 13 Crown corporations. We reported on each of these audits, called special examinations, to both the Crown corporation and Parliament.

2. The purpose of this report is to bring to Parliament's attention important problems occurring in more than one Crown corporation that affected the corporations' management and oversight.

Problems we found

3. We found problems in five important areas:

- Some Crown corporations did not receive timely decisions on their long-term plans.
- There were delays in filling vacancies on boards of directors.
- There was an inherent conflict of interest for some board members.
- There were anomalies in compensation of top executives in two corporations.
- All Crown corporations we examined had weaknesses in managing risk.

4. These problems have made it challenging for Crown corporations to safeguard assets, manage resources efficiently and economically, and fulfill mandates effectively.

Opportunities to improve

5. In our view, government support is needed for Crown corporations to resolve these problems. The government can play an important role in supporting management in Crown corporations by

- improving the ongoing communication about and timeliness of decisions regarding five-year corporate plans;
- having the responsible minister and the Crown corporation work together to bring board appointments up to date;
- having the responsible minister and the Crown corporation work together to ensure that there are proper procedures to manage the inherent risk of conflict of interest when appointing board members who are business stakeholders;

- working with Crown corporations to review the way Chief Executive Officer compensation is established and to take steps to improve transparency by publicly disclosing executive compensation; and
- working with Crown corporations to improve risk management practices—for example, by appointing directors who have extensive risk management experience; by developing improved guidance to corporations that includes best practices; and by ensuring that information in corporate plans includes meaningful descriptions of risk and how the risk is managed.

Crown corporations included in this report

6. Between March 2016 and March 2018, we issued special examination reports on the following 13 Crown corporations:

- **Atlantic Pilotage Authority.** Headquartered in Halifax, the Atlantic Pilotage Authority ensures safe passage of specific types of vessels that travel in and around 17 ports off Canada's east coast. The Corporation ensures that vessels are under the conduct of licensed pilots or holders of pilotage certificates in order to guide the vessels away from danger.
- **Atomic Energy of Canada Limited.** Headquartered in Chalk River, Ontario, Atomic Energy of Canada Limited is responsible for managing the Government of Canada's radioactive waste liabilities by, for example, decommissioning and dismantling nuclear facilities located at its sites, cleaning up contaminated lands, and safely managing the waste. The Corporation also enables research in nuclear science and technology.
- **Canadian Museum for Human Rights.** The Canadian Museum for Human Rights, in Winnipeg, focuses its multimedia exhibits and programs on human rights stories.
- **Canadian Museum of Nature.** The Canadian Museum of Nature, in Ottawa, focuses its research, collections, and exhibits on four areas: plants, animals, minerals, and fossils.
- **Defence Construction (1951) Limited.** Headquartered in Ottawa, Defence Construction (1951) Limited provides services to the Department of National Defence, and others, as an intermediary responsible for procuring and managing defence-related construction projects.
- **Export Development Canada.** With headquarters in Ottawa, 18 offices in Canada, and 19 offices abroad, Export Development Canada provides companies with advisory services and financial products, such as loans and insurance, to develop Canada's export trade.

- **Freshwater Fish Marketing Corporation.** The Freshwater Fish Marketing Corporation owns and operates a processing plant in Winnipeg. The Corporation produces and markets fresh and frozen freshwater fish for sale to wholesalers and the food service industry.
- **Great Lakes Pilotage Authority.** Based in Cornwall, Ontario, the Great Lakes Pilotage Authority ensures safe passage of specific types of vessels that travel in the Canadian waters of the Great Lakes. The Corporation ensures that vessels are under the conduct of licensed pilots or holders of pilotage certificates in order to guide the vessels away from danger.
- **International Development Research Centre.** Headquartered in Ottawa, the International Development Research Centre provides funding to researchers in developing countries in four regions to examine problems crucial to the quality of lives of people in their communities.
- **National Capital Commission.** Based in Ottawa, the National Capital Commission owns and manages over 10% of the lands in the National Capital Region, including various urban parks and many leased properties. The Corporation also manages six official residences, including two residences for the Prime Minister.
- **Pacific Pilotage Authority.** Based in Vancouver, the Pacific Pilotage Authority ensures the safe passage of specific types of vessels that travel along the entire coast of British Columbia and the Fraser River. The Corporation ensures that vessels are under the conduct of licensed pilots or holders of pilotage certificates in order to guide the vessels away from danger.
- **Ridley Terminals Inc.** Based in Prince Rupert, British Columbia, Ridley Terminals Inc. is a marine bulk-handling terminal for coal and petroleum coke. The Corporation unloads rail cars, provides product storage, and loads vessels.
- **VIA Rail Canada Inc.** Headquartered in Montréal, VIA Rail Canada Inc. provides passenger rail service in major cities and 450 communities in all regions of Canada.

7. More information about Crown corporations and special examinations is available on our website at www.oag-bvg.gc.ca (see "What We Do" under "About the OAG").

8. Our audits of Crown corporations support Canada's contribution to the United Nations' sustainable development goals—more specifically, the goal of strong institutions.

Some Crown corporations did not receive timely decisions on their five-year corporate plans

9. For 4 of the 13 Crown corporations we audited, the government did not provide timely decisions on strategies and objectives presented in the corporations' five-year corporate plans. Of these 4 corporations, 2 were facing longer-term funding issues that needed to be resolved. The other 2 corporations had significant changes in their operations that needed the government's timely approval in order to move forward with the proper authority.

Why is this a problem?

10. We are bringing this to Parliament's attention because most Crown corporations are required by the *Financial Administration Act* to submit five-year corporate plans to their ministers every year for approval.

11. In its Guidelines for the Preparation of Corporate Plans, the Treasury Board Secretariat refers to the five-year corporate plan as "the centrepiece of the accountability regime adopted by Parliament for Crown corporations." In exchange for having greater autonomy than government departments, Crown corporations must submit the corporate plans to their responsible ministers annually to inform the government about their activities. The plans set out objectives, strategies, and operational and financial performance measures and targets for the next five years. Corporations are required to operate according to the last-approved corporate plan until the government reviews and approves the new plan. In order for Crown corporations to move forward with any changes necessary to continue to fulfill their mandates, they need ongoing communication from the government about the status of their five-year plans. They also need the government's timely decisions on the strategies and objectives in these plans.

How were Crown corporations affected?

12. We found problems with the five-year corporate plans of four Crown corporations:

- the Canadian Museum for Human Rights,
- the Freshwater Fish Marketing Corporation,
- Ridley Terminals Inc., and
- VIA Rail Canada Inc.

13. In the last four years, the Canadian Museum for Human Rights has submitted corporate plans every year as required. However, the government did not approve the Corporation's plans and did not give the Corporation a reason for not approving them. This was significant because the Corporation was facing near-term funding uncertainties that needed the responsible minister's attention.

14. The Freshwater Fish Marketing Corporation was facing significant changes in its business that affected its ability to fulfill its mandate. Since 2009, the government had not been providing timely approval of the Corporation's five-year corporate plans and had not been telling the Corporation why.

15. Ridley Terminals Inc. had been operating without an approved corporate plan since January 2015. In addition, later in 2015, the Corporation took steps to branch into a new business without receiving the government's approval.

16. VIA Rail Canada Inc. lacked timely approval of its multi-year corporate plans for a number of years. This hampered the Corporation's ability to make multi-year funding commitments that were needed to resolve problems that could compromise its viability.

There were delays in filling vacancies on boards of directors

17. In our audit work, we found that there were often lengthy delays in the government's process for appointing members to the boards of Crown corporations. This was the case for 8 of the 13 corporations we audited. In some instances, these delays limited the boards' ability to function.

Why is this a problem?

18. We are bringing this to Parliament's attention because delays in appointments affect the ability of boards of directors to provide effective oversight, make decisions, and take action when necessary.

19. Each Crown corporation is governed by a board of directors, or a similar governing body, whose number of members is usually defined in the corporation's legislation. The corporation's minister is responsible for appointing the directors with the approval of the **Governor in Council**. Each director is appointed for a specific term, but we found that in some cases, directors continued to sit on boards after their terms expired while they awaited the government's decision on whether to reappoint or replace them. It is a common governance practice to ensure the continuity of corporate knowledge by preventing the terms of all directors on a corporation's board from expiring at the same time.

Governor in Council—The Governor General, acting on the advice of Cabinet, as the formal executive body that gives legal effect to those decisions of Cabinet that are to have the force of law.

How were Crown corporations affected?

20. In 8 of the 13 Crown corporations we audited, there were delays in appointments, which resulted in

- a significant number of unfilled positions,
- directors continuing to sit despite expired terms, and
- sitting directors whose terms would expire shortly.

21. Here are two examples of the impact of delays and unfilled positions:

- At the International Development Research Centre, the Board could sometimes not make decisions because, on occasion, only 7 of its 14 positions were filled.
- At the Freshwater Fish Marketing Corporation, 6 out of a total of 8 director positions were vacant. This affected the Corporation's ability to deal with significant changes in its operations and to manage the actions of the then Chief Executive Officer, who was subsequently removed from his position.

22. There can also be a cumulative effect of delays in board appointments. For example, at the Canadian Museum for Human Rights, of 11 board positions, 2 were vacant, including the chair; 3 directors continued to sit after their terms had expired; and the terms of 2 more directors were due to expire soon. This meant that 7 out of 11 positions could be replaced at the same time, which would result in a loss of corporate knowledge.

There was an inherent conflict of interest for some board members

23. In 4 of the 13 corporations we audited, the boards included stakeholders in the business, who could potentially benefit from board decisions. Some Crown corporations' legislation either requires representatives from industry, labour, or other stakeholders to sit or does not prevent them from sitting on the boards of directors. Such boards must therefore manage the inherent risk of perceived or actual conflict of interest.

Why is this a problem?

24. We are bringing this to Parliament's attention because boards of directors of Crown corporations need to be objective in decision making. When board members are specifically selected from stakeholder groups, the board must be especially aware of potential conflicts of interest and manage them to ensure that board members respect their legislated obligations, including their duty to act in the best interest of the corporation.

How were Crown corporations affected?

25. Business stakeholders were appointed to the boards of directors of four Crown corporations:

- the Atlantic Pilotage Authority,
- the Freshwater Fish Marketing Corporation,
- the Great Lakes Pilotage Authority, and
- the Pacific Pilotage Authority.

26. The Pacific Pilotage Authority's Board of Directors is a good example of an inherent conflict of interest. The Minister of Transport had a long-standing practice of appointing directors who were representatives of the Corporation's contract pilots or of the shipping industry, the Corporation's customer. At the time of our audit, the Board had no protocol for its members to disclose conflicts of interest on an ongoing basis. The Board was making decisions about changes in regulations, in the contract for pilots, and in tariffs paid by the shipping industry.

27. In the case of the Freshwater Fish Marketing Corporation, some Board members were representatives of the fishing industry. These industry representatives took part in the decisions on how much the Corporation would pay fishers. The Corporation's conflict-of-interest code stated that Board members having interests in delivering fish to the Corporation did not constitute a conflict of interest. However, in our view, it clearly did.

There were anomalies in compensation of top executives in two corporations

28. In two recent special examinations, we reported anomalies in the compensation of top executives. In one case, the corporation went outside the government's appointment process to hire its top executive, and it established the executive's compensation through a contract. In the other case, the total compensation range of the Chief Executive Officer (CEO) established by the government (the Governor in Council) was lower than the total compensation range for other executives whose compensation was determined by the corporation according to market standards.

Why is this a problem?

29. We are bringing this to Parliament's attention because we are concerned that these anomalies may indicate that the government is not aware of the relationship between compensation levels set by the government for the CEOs in all Crown corporations and those set by the corporations for their other executives. These compensation levels are not disclosed publicly. Public disclosure of executive compensation is a widely accepted practice in the public and private sectors and can serve to inform the government of issues. Furthermore, we found that one of the corporations went outside the government's processes both to hire and to compensate the top executive. We are concerned that without government attention, this could happen again.

How were Crown corporations affected?

30. We reported on CEO compensation for the following Crown corporations:

- Ridley Terminals Inc., and
- Export Development Canada.

31. In November 2016, the Board of Ridley Terminals Inc. went outside the Governor in Council appointment process and hired a president and chief operating officer (using a different title) on contract at a compensation level substantially higher than that set by the government. In the Board's opinion, the government compensation would not attract the right skill set or provide incentives for top candidates to work at Ridley Terminals Inc. This hiring action does not comply with the *Financial Administration Act*. Further, the Department of Transport knew that the Corporation intended to hire outside the process, but the Department did not make sure that the Corporation followed the Governor in Council appointment process for hiring a new president and chief operating officer.

32. At Export Development Canada, the Corporation followed the government appointment and compensation processes for the CEO. However, the CEO total compensation range was now less than the total compensation range for other executives who reported to him, and the compensation gap had widened because the CEO compensation range set by the government had not been revised since 2012.

Crown corporations had weaknesses in managing risk

33. In our audit work, we found that all 13 corporations had weaknesses in, and needed to improve, their risk management practices. These weaknesses indicated that the corporations needed to do more to minimize potential losses and to avoid disrupting their operations.

Why is this a problem?

34. We are bringing this to Parliament's attention because Crown corporations need to have good risk management practices in place to manage the potential risk of losses and avoid disruptions in their operations. Crown corporations have varying mandates and operate in many sectors of the Canadian economy, including transportation, energy, agriculture and fisheries, financial services, culture, and government services. Crown corporations' mandates can include conserving Canadian culture and heritage, delivering important services, and in some cases, protecting the health and safety of people and the environment. Collectively, Crown corporations manage billions of dollars in public assets. Crown corporations need good risk management practices that reflect the nature of their operations and the assets they safeguard.

35. While risk management practices can be complex and continually improving, the techniques that form the basis for risk management are well developed. The risk management process starts with identifying risks to achieving objectives and with assessing the potential impact of these risks. The next step is developing an action plan with timelines on ways to mitigate these risks. The final step is monitoring and reporting on progress on mitigating risk. Crown corporations need to follow good risk management practices in order to have assurance that they are adequately safeguarding their assets and managing the risk of losses and disruptions in operations.

How were Crown corporations affected?

36. We found that 6 of the 13 Crown corporations we examined had weaknesses in the identification and assessment of the possible risks they faced. For example, Defence Construction (1951) Limited did not consider all aspects of fraud risks, such as the risk of failing to manage potential allegations of fraud, corruption, and collusion.

37. We also found that 6 corporations had weaknesses in developing action plans to mitigate risks. For example, the Great Lakes Pilotage Authority had not fully implemented its planned risk mitigation strategies for the monitoring of pilotage certificate holders and of the transits of Canadian vessels, and for the performance management of pilots.

38. We found that 10 corporations did not effectively monitor and report on risks. For example, in the case of Atomic Energy of Canada Limited, which is responsible for overseeing a contractor responsible for the safe dismantling of former nuclear sites and disposal of contaminated waste, the Corporation’s Board did not have a formal process for monitoring identified risks.

39. Six Crown corporations had weaknesses in more than one of their risk management processes. For example, Export Development Canada, whose mandate is to support Canadian exporters around the world, had not yet completed the multi-year implementation of its updated approach to risk management, to catch up with current industry practices. As a result, it still had weaknesses in its corporate risk practices and in some aspects of its credit risk management practices.

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