

Chapter

7

Governance of Crown Corporations

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Governance of Crown Corporations

Main Points

7.1 Overall, progress in addressing the recommendations from our 2000 audit of Crown corporation governance has been unsatisfactory. Individual Crown corporations have strengthened their own governance structures and practices. However, improvements that we recommended to strengthen the overall governance and accountability framework have not progressed as quickly and as far as we had expected.

7.2 Still, we found fewer gaps in the collective skills and expertise of board members. We also found that the composition and operating practices of board audit committees had improved and that audit committees are operating more effectively than in 2000.

7.3 Indications that governance practices have either not improved or improved slowly include the following:

- It took more than three years for the government to address some of our key 2000 recommendations by starting the Treasury Board Secretariat review of corporate governance in February 2004.
- A revised process for appointing Crown corporation boards of directors, chairs, and chief executive officers (CEO) was announced in March 2004 but has not yet been fully defined and implemented.
- Board, chair, and CEO appointments still take too long and terms of board members are not adequately staggered.
- We found very little progress in assessing the capacities and skills needed by the government to review corporate plans and ensure the continued relevance of Crown corporation mandates.
- The responsibilities and expectations of the government regarding Crown corporations still need to be clarified.

Background and other observations

7.4 This chapter assesses the progress that the government and Crown corporations have made in dealing with the concerns we reported in 2000. It also discusses recent developments in corporate governance elsewhere and their possible implications for the governance and accountability framework of Crown corporations.

7.5 Developments in corporate governance are raising the expectations for publicly traded corporations. These developments have yet to be adapted to the governance practices expected of Crown corporations. The emerging private

sector practices that we think are the most relevant to Crown corporations are the following:

- ensuring that the board plays a key role in its own renewal and in the selection of the chair and CEO;
- strengthening the independence of boards and audit committees;
- requiring that the mandate and operations of the board be defined;
- strengthening corporate values and ethics practices; and
- improving the quality of reporting and disclosure.

At the time of writing this chapter, the Treasury Board Secretariat's review of Crown corporations' governance was still underway. The Secretariat informed us that it is considering these issues in its review.

The government has responded. The Treasury Board Secretariat states that the government remains committed to improving the governance of Crown corporations. The Treasury Board Secretariat also states that the current government's review of Crown corporation governance is examining many of the issues identified in the chapter and will address our recommendations.

Reaction from Crown corporation chairs and CEOs indicates that, for the most part, they agree with the recommendations directed specifically at them.

Introduction

7.6 Crown corporations are distinct legal entities that are wholly owned by the government. They deliver important public programs and operate in many sectors of the Canadian economy, including financial services, culture, transportation, agriculture and fisheries, energy and resources, and government services.

7.7 Crown corporations account for a significant portion of government activity. There are currently 43 federal Crown corporations (not including subsidiaries), employing 73,100 people. In aggregate (excluding the Bank of Canada), they manage \$78 billion in assets. Parliamentary appropriations to Crown corporations amounted to \$5.2 billion in 2003–04.

7.8 While Crown corporations represent a significant opportunity to achieve public policy and other goals and to generate revenue, they also represent significant exposure to potential financial losses and other risks. It is critical that Crown corporations, as public sector entities, be well governed if taxpayers' money is to be well managed.

7.9 Corporate governance refers to the process and structure for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively.

7.10 The legislative framework for the governance and accountability of most federal Crown corporations is set out in Part X of the *Financial Administration Act* (FAA). For some “exempt” corporations where Parliament wanted to create further distance from the government, the governance and accountability regime is normally set out in their enabling legislation. In addition to these legislative requirements, governance principles and practices for Crown corporations are contained in various other documents such as governance policies, guidelines, and practices issued by the Treasury Board Secretariat and the Privy Council Office. Individual Crown corporations also establish their own internal policies and practices on governance.

7.11 The governance regimes attempt to balance the Crown corporation's relationship with the government—between the corporation's autonomy in day-to-day activities and the government's appropriate direction and control. The legislation places the board of directors at the centre of the governance regime for Crown corporations. Under this governance regime, the board oversees the management of each corporation and holds management responsible for its performance; it is responsible for establishing the corporation's strategic direction, safeguarding the corporation's resources, monitoring corporate performance, and reporting to the government and Parliament. The corporation is accountable to Parliament through a responsible minister.

7.12 Although the formal ownership structure varies among federal Crown corporations, in substance, the Government of Canada acts as the shareholder for federal Crown corporations and will be referred to as such in

the remainder of this chapter. In practice, several individuals and organizations are involved in the discharge of the government's responsibilities in relation to Crown corporations:

- the Governor in Council
- the responsible minister, deputy minister, and department
- the Treasury Board and its Secretariat
- the Minister and Department of Finance Canada
- the Privy Council Office
- the Prime Minister's Office

7.13 Our audit in 2000 assessed how well three key aspects of corporate governance required by the *Financial Administration Act* were functioning in Crown corporations:

- the process of appointing directors, the board chair, and the chief executive officer (CEO);
- the composition, role, responsibilities, and performance of the board's audit committee; and
- the government's capacity to set and communicate performance expectations, review and challenge the corporation's corporate plan before approving it, and ensure that the Crown corporation's mandate continues to be relevant.

Important developments and initiatives since our 2000 audit

7.14 Following the recent corporate scandals in the United States and Canada, legislators and securities regulators in both countries have focussed on strengthening governance practices in publicly traded corporations. Considerable attention has been given to the need to set clear expectations for the performance of boards, audit committees, and management, and for the disclosure of information to various stakeholders. Legislation in the United States (*Sarbanes-Oxley Act*) and actions of securities regulators in Canada are turning these new expectations for good governance into requirements.

7.15 In February 2004, the President of the Treasury Board announced a series of reviews of government operations and management, including the *Financial Administration Act*, the governance of Crown corporations, and the accountabilities of ministers and senior public servants. Our Office has provided input to these reviews, including our perspective on the governance of Crown corporations and the accountability framework in Part X of the FAA, and our suggestions for improving them. At the end of our follow-up, the Treasury Board Secretariat had not yet completed its reports on these reviews.

7.16 Another significant development is the Commission of Inquiry into the Sponsorship Program and Advertising Activities (the Gomery Commission). The Commission's mandate includes examining the adequacy of the current

accountability framework for Crown corporations. The Commission is still holding hearings and is currently scheduled to report in December 2005.

7.17 In February 2004, the government stated that “a transparent appointment system must be put in place to ensure that citizens have confidence that the best people to serve Canadians are being appointed to public institutions.” In March 2004, the government announced important changes to the process for appointing directors, chairs, and CEOs of Crown corporations. At the time of writing the chapter, this revised process was still being implemented.

Focus of the follow-up

7.18 This chapter reports on the extent of the government’s and Crown corporations’ progress in addressing the recommendations from our 2000 Report and our 2002 audit observation on compensation to executives of Crown corporations.

7.19 In 2001, the House of Commons Standing Committee on Public Accounts held a hearing on our 2000 chapter; its report in early 2002 echoed many of our concerns and made 10 recommendations to the government. In Appendix A, we summarize the status of the government’s actions to address each of the Committee’s recommendations.

7.20 In this chapter we also discuss recent developments in the governance practices of publicly traded corporations and our views on their relevance to federal Crown corporations.

7.21 Further details on the objectives and scope of our follow-up audit are included in **About the Follow-Up**, at the end of the chapter.

Observations

Appointing directors, board chairs, and chief executive officers

7.22 In a “board-centered” model of governance, the board of directors is responsible for the affairs of the corporation. For good governance, it is essential that the process of selecting and appointing people to the board gives it the right combination of skills and abilities to carry out its mandate and responsibilities effectively.

7.23 Our audit in 2000 found that the government needed to strengthen its appointment process to address the following weaknesses:

- Crown corporations needed to define more clearly the skills and capabilities required on their boards, and the government needed to act on those requirements.
- Although board membership reflected Canada’s diversity, it lacked some of the key skills and capabilities needed to oversee the corporation’s affairs effectively.
- New directors were given orientation training but were not briefed adequately on their duties and responsibilities, the corporation’s

relationship to the government, policies on the compensation of Crown corporation executives, and board procedures.

- Boards of directors were not engaged enough in the renewal of the board and the selection of its chair.
- Appointments to boards were not timely and directors' terms were unevenly staggered, a serious problem that undermined the continuity and stability of boards.

We also advocated a “board search” model for the selection of the chief executive officer, in which the board would play a key role.

Despite some improvements, weaknesses in the appointment process remain

7.24 In our follow-up audit, we reassessed the appointment process in place before the government announced the revised process in March 2004. We found a number of improvements; however, some key concerns we raised in 2000 had not been resolved.

7.25 Following our 2000 audit, the Privy Council Office (PCO) issued a guide to assist Crown corporations in preparing directors' profiles. It subsequently requested all Crown corporations to develop/update their profiles. We noted that most Crown corporation boards now have in place director profiles, most of which reflect the diversity of Canada and the skills and abilities needed to oversee the affairs of the corporation. The expected skills and abilities include, among others, financial and human resources expertise, industry-specific knowledge, and personal and other qualities. Boards use the profiles to identify gaps in the needed mix of skills and communicate in writing to responsible ministers and the PCO. There are now more directors who have the skills and abilities expected by board profiles, especially financial expertise and financial literacy.

7.26 In 2003, the PCO established an orientation course for new directors in response to our 2000 recommendation. The new course covers board procedures, compensation policies, the director's fiduciary responsibilities to the corporation, and the corporation's relationship to the government. The PCO informed us that, so far, 80 percent of Crown corporations have participated in the training program.

7.27 However, some key concerns we noted in 2000 had not been resolved. We noted difficulties in bringing people onto boards with the needed skills, abilities, and experience. It took one corporation two years, and repeated requests, to have the government appoint a member to its board with the proper financial expertise.

7.28 The *Financial Administration Act* requires the responsible minister to consult with the board prior to the appointment of a chair or CEO. However, we found that the government's consultation with boards on the selection of a chair had been uneven.

7.29 Crown corporations were still not making systematic use of a “board search” model to ensure that the board plays a key role in selecting a new CEO. A selection process that does not involve the board weakens the

accountability relationship between the board and the CEO. If CEOs are not appointed or selected by the board, they may believe that they are accountable to the organization or individual that selected and appointed them. As discussed later in the chapter, the revised appointment process announced in March 2004 provides for board involvement in the appointment of chairs and CEOs.

Appointments are not timely, and terms are still not evenly staggered

7.30 The timeliness of appointments of directors, board chairs, and CEOs is still a major issue. In fact, the length of time that board members continue to serve after their terms as directors have expired has increased by 20 percent since we raised this concern in 2000. As shown in Exhibit 7.1, at September 2004, over one third (56) of directors (excluding CEOs, chairs, and directors from the public sector) of the 15 largest Crown corporations

Exhibit 7.1 Timeliness of appointments of directors to Crown corporations' boards

Number of terms expired and average time since expiration (15 largest Crown corporations*)

Fifteen largest Crown corporations	Number of directors (excluding CEOs, chairs, and directors from the public sector)	Number whose terms have expired	Average time since term expired, at September 2004 (days)
Atomic Energy of Canada Limited	15	5	199
Bank of Canada	12	2	397
Business Development Bank of Canada	11	5	420
Canada Deposit Insurance Corporation	5	2	250
Canada Mortgage and Housing Corporation	7	4	239
Canada Pension Plan Investment Board	11	5	340
Canada Post Corporation	9	1	112
Canadian Broadcasting Corporation	9	5	149
Export Development Canada	11	6	439
Farm Credit Canada	10	1	34
Marine Atlantic Inc.	11	0	N/A
National Capital Commission	14	5	322
Public Sector Pension Investment Board	9	4	187
Royal Canadian Mint	8	3	62
Via Rail Canada Inc.	13	8	135
Total	155	56	

*15 largest Crown corporations by number of employees, assets, and revenues

Source: Privy Council Office

were still sitting on boards while their terms had expired. In 9 corporations, the average length of time that directors had served since their term expired was more than six months.

7.31 At the time of writing this chapter, four major Crown corporations (Via Rail Canada Inc., Business Development Bank of Canada, Export Development Canada, and Canada Post Corporation) had CEOs who had been acting in the position temporarily, in some cases, for more than eight months. These four Crown corporations represent some of the largest corporations in Canada, managing assets totalling \$37.3 billion and employing 51,000 people. In our view, these senior positions need to be filled by permanent CEOs on a high-priority basis.

7.32 Appointments to the board are still not staggered evenly, increasing the risk that continuity of expertise and corporate memory will be lost. For example, one Crown corporation was in the process of replacing or renewing the appointments of 8 of its 12 directors during 2004. In addition, we have identified 12 corporations in which the terms of the majority of their directors will expire in the same year. The *Financial Administration Act* sets the terms of directors of Crown corporations to up to three years. In our view, increasing this limit could facilitate the staggering of appointments.

The revised appointment process could improve Crown corporation governance

7.33 In March 2004, the government announced important changes to the process for appointing directors, chairs, and CEOs of Crown corporations. Following the announcement, the process was further refined. In April 2004, the President of the Treasury Board advised individual Crown corporations that their organization was required to follow this process in the future for appointment of the CEO, board of directors, and chairperson, unless the enabling legislation of their organization provided otherwise (see Appendix B).

7.34 At the time of writing this chapter, the government had appointed only a small number of new directors to boards of Crown corporations since the March announcement. In early October 2004, the Privy Council Office informed us that the revised appointment process was still being refined—for example, parliamentary committees were still looking at the positions that would be subject to their review. The Treasury Board Secretariat advised us that its review of Crown corporation governance will also address the appointment process.

7.35 In our view, the revised process has the potential to address many of the issues we raised in 2000. It reflects some of the best practices in Canada and in other jurisdictions. For example, boards of directors, through their nominating committees, would play a significant role in board renewal by screening and recommending suitable candidates for director positions; that should contribute to removing any remaining gaps in skills and abilities. In screening those candidates, the nominating committee will need to pay particular attention to their personal and other qualities, such as being

independent-minded, that could have an impact on board dynamics and the board's effectiveness in challenging management.

7.36 There are only a few Crown corporations where the CEO is appointed by the board of directors. In most cases, CEOs are appointed by the Governor in Council. For the latter corporations, the revised process gives the board of directors a larger role than previously in identifying potential candidates for the CEO positions and recommending them to the minister. This is a significant step in enhancing the involvement of the board, although it differs from practices in the private sector. There, the board of directors is responsible for the selection, appointment, and termination of the CEO. In our view, having the board of directors play the lead role in selecting the CEO will contribute to enhancing his/her accountability to the board.

7.37 However, the problems of timeliness and staggering of appointments may not necessarily be corrected by the revised process. It will be important for the government to ensure that these issues are properly addressed.

7.38 The appointment process for senior executives of Crown corporations provides that some steps do not necessarily have to be followed. In our view, exceptions to the process need to be well supported and their rationale made public.

7.39 Although the revised process has the potential to improve Crown corporation governance, it will not be possible to assess its effectiveness until the process operates for some time.

The functioning of audit committees

7.40 The audit committee is a core committee of the corporation's board of directors and an essential part of good corporate governance. How it performs is an indication of how well the corporation's governance regime is functioning. In 2000, we looked at the performance of 14 Crown corporation audit committees. We compared their practices with about a dozen recognized best practices at the time in Canada and elsewhere to provide a basis for future self-assessment and to identify any potential for improvement in their performance.

7.41 We reported in 2000 that half of the 14 audit committees were ineffective or only marginally effective. As part of this follow-up, we returned to each of those committees to assess their progress against the same best practices we had used as benchmarks in 2000 (Appendix C sets out those practices).

Audit committees have improved their performance

7.42 Our follow-up audit found that Crown corporation audit committees are now following many of the best practices we identified in 2000 and have generally improved their performance.

7.43 Thirteen of the committees have charters or terms of references that reflect the best practices we identified in 2000. For example, the charters acknowledge key audit committee responsibilities such as overseeing the financial reporting process and the audit regime, and reporting to the full board of directors. We also noted a significant improvement in some

committees' oversight of corporate risk management and the internal control environment. Operating procedures of 11 of the 14 audit committees include regular private meetings with the auditors and with management.

7.44 In general, audit committee members are financially literate. They now have stronger financial skills and abilities and consequently have been more effective in reviewing and challenging management's actions and proposals. Overall, we found that nine of the audit committees now fulfill their roles and responsibilities effectively; the five others are still marginally effective.

7.45 Still, there is room for further improvement in how audit committees function in a number of Crown corporations. We noted individual cases where, for example, the audit committee did not effectively challenge management. The quality of information provided to the audit committee could be improved (information could be more timely and complete). In some cases, the committee could better demonstrate how it fulfills its responsibility for overseeing the ethical practices of the corporation; this could be done through an annual review of management's compliance with the corporate code of conduct. Finally, some audit committees were still not playing an active role in soliciting information about significant risks and exposures and reviewing the adequacy of internal controls to manage those risks.

7.46 In October 2003, the Treasury Board Secretariat issued *Guidelines for Audit Committees*. These guidelines suggest best practices for audit committees of federal Crown corporations. They present practices to help individual audit committees improve their effectiveness. Boards of directors and audit committees are to tailor the guidelines to meet their specific needs. As mentioned later in this chapter, with expectations for audit committees continuing to increase, the guidelines need to be updated to show clearly what the government expects of effective audit committees.

Clarifying relationships and expectations with the shareholder

7.47 Establishing and following good governance practices provide assurance to the shareholder and stakeholders that the corporation is being managed in an appropriate way to achieve the expected results. Ensuring that the roles and responsibilities of all key parties in governance are clear, that performance expectations are set and understood, and that all parties are accountable for their performance contributes to the achievement of corporate objectives.

7.48 We reported in 2000 that the government had limited knowledge and expertise to challenge the corporate plans of Crown corporations. Our special examinations had identified weaknesses in the strategic planning of 66 percent of Crown corporations. Thus, the government was approving many deficient corporate plans.

7.49 We also noted that only two Crown corporations had been subject to mandatory and systematic mandate reviews. Other corporations carried out mandate reviews on a generally ad hoc basis, and many reviews did not engage the Treasury Board, the responsible minister, and Parliament or address all significant issues. Thus, we recommended that the government develop guidelines for conducting mandate reviews.

7.50 In 2000, we also found that the roles and responsibilities of key players in Crown corporation governance needed to be clarified. Further, we noted that no process of formal communication was in place between each Crown corporation and the responsible minister to provide for needed dialogue and consensus. In addition, we found that half of corporations that we examined rarely saw their minister.

7.51 We concluded that these weaknesses impeded the successful implementation of Part X of the *Financial Administration Act* (FAA) and affected the quality of Crown corporation governance. In our follow-up audit, we found little progress in addressing these issues.

Weaknesses remain in the review of corporate plans and mandate relevance

7.52 Feedback from the government on corporate plans is still limited. Neither the Treasury Board Secretariat nor the applicable departments have clearly defined their respective roles in the process for reviewing and approving corporate plans or assessed the capacity and skills needed to fulfill their roles.

7.53 Recent special examinations of Crown corporations continue to reveal weaknesses in corporate planning. Many Crown corporations still are not setting clear goals and indicators of performance for their public policy objectives. Some deficient corporate plans are still being approved.

7.54 Crown corporations that undergo mandate reviews are still the exception, and the reviews are still usually carried out on an ad hoc basis. There are still no guidelines for conducting mandate reviews. In Chapter 8 of our November 2004 Report to Parliament, we commented on Telefilm Canada; its corporate activities had changed but its mandate had not been amended to authorize the changes (Exhibit 7.2). Periodic and systematic

Exhibit 7.2 Telefilm Canada—Most of its activities are not consistent with its constituting legislation

The mission of Telefilm Canada, as stated in the *Telefilm Canada Act*, is to foster and promote the development of the feature film industry in Canada. Since the adoption of the Act in 1967, the activities of the Corporation have extended to the television, new media, and music sectors through memoranda of understanding and/or contribution agreements with the Department of Canadian Heritage. The majority of the Corporation's expenses are related to these new sectors of activity.

This expansion of Telefilm Canada's role and responsibilities in the development of the audiovisual and cultural industries has not been matched by an updating of its legislative mandate and powers—which today, 37 years after Telefilm Canada's creation, are still limited to developing the feature film industry. Parliament has not ratified the government's decision to extend Telefilm Canada's mandate to other sectors of activity. In our opinion, if the government intends to have Telefilm Canada support the development of the television, new media, and music industries, it is important that it bring forward the changes needed to modernize the Act. At the time of writing this chapter, the government had just tabled Bill C-18 in the House of Commons to update Telefilm's mandate. The Bill was referred to the Standing Committee on Canadian Heritage for review.

mandate reviews would help Parliament and the board ensure that the corporation's mandate is relevant to the government's policy objectives and the corporation's operating environment.

Relationships and accountability still need to be clarified

7.55 As mentioned previously, the *Financial Administration Act* places the board of directors at the centre of the governance regime for Crown corporations. The government retains power and influence over Crown corporations in areas such as appointment and remuneration of directors, chairs, and chief executive officers; directives and regulations; and approval of corporate plans and budgets. While the government's authority for Crown corporations rests with the responsible minister, in practice several players are involved in these areas.

7.56 Over the years, we have found that various representatives of the government do not always speak with one voice. While Part X of the FAA indicates that Crown corporations are accountable to Parliament through the responsible minister, it is not always clear what ministerial responsibility for a Crown corporation means in practice. The Gomery Commission and the Treasury Board Secretariat's reviews have mandates to explore this issue. Clarifying the corporation's relationship to the government and who speaks for the shareholder are essential for good corporate governance of all Crown corporations, including those exempt from Part X of the FAA.

7.57 Our 2000 chapter raised concerns about the role played by senior public servants appointed to the boards of some Crown corporations. In our view, representatives of the government, such as deputy ministers, can too easily be viewed as having a "super voice" and thereby unduly affect the direction of the board. Boards require access to public sector decision makers but not necessarily as members of the board.

7.58 In recent special examinations, we noted a lack of clarity among board members about the role of directors from the public sector. At times, board members deferred to them because they were considered to speak for the government. While directors from the public sector may have the knowledge and expertise to help other board members appreciate the government's position on certain issues, their function is not to convey direction from the minister to the board. They have the same statutory obligations as any other director: to exercise independent judgment in ways that best fulfill their responsibility to the corporation. Having the fiduciary responsibility to act in the best interest of the corporation and owing loyalty to their minister can place them in difficult situations at times. In our view, it is important to reassess the merits of having public sector directors on boards.

Communicating expectations—governance protocols between ministers and Crown corporations

7.59 There is still no formal process for setting out high-level expectations of the responsible minister before the corporate plan is developed. In practice, the relationship between boards of directors and responsible ministers varies—some meet regularly; others do not. A process to ensure that

expectations are clear could help the board and the minister establish a mutual understanding of the corporation's mandate, the related performance expectations, public policy issues, and the shareholder's strategic priorities. This would be useful to the board in establishing the corporation's strategic direction and developing the corporate plan.

7.60 In other jurisdictions, there have been some efforts to clarify and publicly disclose shareholders' policy objectives and expectations. For example, the government of British Columbia now has a governance structure designed to clarify the relationship between the Province and provincial Crown corporations (Exhibit 7.3). We understand that communication between the responsible ministers and the corporations has improved. Such a governance structure should help to clarify the relationship between the corporation and the responsible minister and should ensure that the government speaks transparently and with "one voice."

Exhibit 7.3 A process used to clarify expectations between the government and a Crown corporation

In the British Columbia model, the minister responsible for the Crown corporation, as the representative of the government, communicates broad strategic direction and expectations as determined by the Cabinet. This direction and formal expectations for the Corporation are communicated annually in a "letter of expectations" that is also signed by the Crown corporation board's chair and made public. This letter also identifies actions the government will take to assist the Crown corporation in achieving mandate and operational objectives. The minister responsible for the corporation is the voice of the government. By playing a role in establishing the corporation's direction and the government's expectations of it, the minister is reflecting the expectations of the owner and there is a basis for accountability for the corporation's actions. In this model, the minister does not take over the role of the board but communicates formally and publicly the performance that the government expects from the corporation. The board is responsible for governing the corporation within that framework.

Source: Office of the Premier, Province of British Columbia

7.61 A clear role for the minister in establishing and communicating formal, high-level expectations of the corporation would also help ensure the continued relevance of a Crown corporation's mandate. Special considerations may need to be taken into account for Crown corporations that are presently exempt from Part X of the *Financial Administration Act*.

Disclosure of executive compensation

7.62 In December 2002, we reported the need for improved transparency of senior executives' salaries and other compensation. In the two years since our audit observation, very little has happened. Only a few federal Crown corporations disclose some information on executive compensation. Corporations listed on stock exchanges are required to disclose the total compensation (including remuneration and benefits) of senior executives and board members. These practices reinforce that a best practice is for boards and executives to disclose such information.

Implications of Recent Developments in Corporate Governance

New Canadian expectations

7.63 As mentioned earlier in the chapter, the recent corporate scandals in the United States and Canada have led legislators and securities regulators in both countries to strengthen their requirements for the governance practices of publicly traded corporations. In the United States, these requirements were set out in the *Sarbanes-Oxley Act of 2002*. In Canada, securities regulators have proposed expected best practices in National Policy 58-201, which are similar to those in the United States. These proposals now set clear expectations for the performance of boards of directors, audit committees, and management, and for the disclosure of information to various stakeholders.

7.64 Although Crown corporations are not subject to these proposed requirements, we believe that many of the principles underlying them are relevant to the public sector environment and key aspects of them would strengthen the governance practices of Crown corporations and their accountability to Parliament. As part of our ongoing audit work in Crown corporations, we noted the significant efforts of some in the last two years to review and improve their own internal governance policies and practices. Some have already addressed these proposals or are in the process of doing so.

Strengthening the board

7.65 Composition of the board. Securities regulators in Canada now recommend that the majority of board members be independent, that the independent members hold regular meetings without management in attendance, and that the board chair be an independent director (that is, the chair and CEO positions should be separate).

7.66 These best practices are not always adopted in Crown corporations. We noted that the practice of holding board meetings without management in attendance is uneven. Further, in a few Crown corporations, the same individual acts as chair and CEO. Finally, as mentioned in paragraphs 7.57 and 7.58, the presence of directors from the public sector on a board of a Crown corporation needs to be reassessed.

7.67 Board mandate. Securities regulators propose that a board adopt a formal mandate in which it assumes its stewardship responsibility, including its responsibility to

- satisfy itself of the integrity of the CEO and other senior officers and their promotion of a culture of integrity;
- adopt a strategic planning process and approve at least annually a strategic plan that takes into account opportunities and risks of the corporation;
- identify principal risks of the business and ensure that appropriate systems are put in place to manage those risks;
- plan for succession;

- ensure the integrity of internal control and management information systems; and
- develop an approach to corporate governance that includes governance principles and guidelines specific to the corporation.

7.68 Board mandates will need to set out decisions that require prior approval by the board, measures for receiving feedback from security holders (in the case of a Crown corporation, the shareholder), and the board's expectations of management.

7.69 In our view, all these responsibilities are consistent with expectations for Crown corporations, including those established in the *Financial Administration Act*. Section 131 (2) of the FAA requires boards of Crown corporations to have reasonable assurance that the systems and practices of the corporation safeguard and control the corporation's assets; that the financial, human, and physical resources of the corporation are managed economically and efficiently; and that the operations of the corporation are carried out effectively. As Crown corporations update their board mandates, they should ensure that these requirements, as well as those established in the FAA, are taken into account.

7.70 Orientation and continuing education. Regulators propose that all new directors receive a comprehensive orientation and that the board provides opportunities for continuing education to all board members. We have already noted that the federal government recently developed an orientation course for directors of Crown corporations. However, much remains to be done by the government and the Crown corporations in providing continuing education. It is important to put the mechanisms in place to ensure that directors have access to continuing education programs in areas such as public sector developments, governance practices, financial literacy, and risks management.

7.71 Code of business conduct and ethics. Boards in publicly traded companies will be required to adopt a written code of business conduct and ethics that is applicable to directors, officers, and employees. The code is to address such issues as conflict of interest; protection and proper use of corporate assets and opportunities; fair dealing with customers, suppliers, competitors, and employees; confidentiality of corporate information; compliance with laws, rules, and regulations; and reporting of any illegal or unethical behaviour. The board will be responsible for monitoring compliance with the code and ensuring that the corporation's ethical standards and values are observed and that the corporation discloses how fully they are observed.

7.72 In our view, the need for boards to establish and monitor values and ethics codes is equally important in Crown corporations as in publicly traded companies. In addition to business ethics, Crown corporations need to reflect values such as serving the public interest. Although our follow-up work did not cover this issue, we noted in our other audit work that many Crown corporations are now reviewing their values and ethics programs and infrastructure. A number of others have already implemented some of the best practices in that area.

7.73 As Crown corporations review their values and ethics programs, they need to reflect both private sector expectations and the principles underpinning the new *Values and Ethics Code for the Public Service*. The government has asked all public service institutions not covered by the Code, including Crown corporations, to respect the Code's spirit and adopt similar provisions for their organizations. A related document is the *Conflict of Interest and Post-Employment Code for Public Office Holders*. This Code applies to order-in-council appointees such as directors, chairs, and CEOs of Crown corporations. Exhibit 7.4 summarizes the key principles of this conflict of interest code.

7.74 In our view, the development and implementation of codes of conduct and ethics are essential elements of good governance. We intend to examine this area in the future, given that many Crown corporations are currently reviewing their ethics and values programs and infrastructure.

7.75 Regular board assessments. Boards and board committees of publicly traded companies will be expected to assess their collective effectiveness as well as the effectiveness and contribution of each board member. The assessment is to consider the board's written mandate, the charter of each board committee, and the competencies and skills each director is expected to bring to the board. As noted in our 2000 Report, we support board assessments as a best practice that should be implemented in Crown corporations. Such assessments could help boards identify opportunities to improve their practices or identify skills and abilities that need to be added to the board or its committees.

7.76 In our recent special examinations of Crown corporations, we noted that a number of boards are assessing the board's collective effectiveness and its committees. However, we also noted the need for more effort in assessing the contributions of individual board members. This is important if boards are to improve their effectiveness and fulfill their responsibility for renewal.

7.77 Director compensation. In the private sector, the roles and responsibilities of boards of directors—and, more specifically, audit committees—have increased significantly in the last few years. This has resulted in a greater demand for highly qualified people. A recent study reported that, in 2001, compensation to directors in the private sector averaged about \$19,000 in annual retainer fees and \$1,300 for attending each board meeting. Current literature shows that these fees are significantly higher today, reflecting the increased responsibility and accountability of board directors.

7.78 In Crown corporations, the recommended annual retainer fee ranges from \$2,600 to \$10,300, and fees for attending board meetings are between \$160 and \$800. These compensation levels have not changed in the last four years. Chairs and CEOs of Crown corporations have said that compensation has not kept up with the increase in workload and responsibilities. In our view, as the government decides to increase responsibilities of boards of directors, it may want to review the compensation paid to directors in order to confirm its appropriateness in attracting and keeping those who are best qualified.

Exhibit 7.4 Values and ethics for public office holders—key principles

Ethical standards	Public office holders shall act with honesty and uphold the highest ethical standards so that public confidence and trust in the integrity, objectivity, and impartiality of government are conserved and enhanced.
Public scrutiny	Public office holders have an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.
Decision making	Public office holders, in fulfilling their official duties and responsibilities, shall make decisions in the public interest and with regard to the merits of each case.
Private interests	Public office holders shall not have private interests, other than those permitted pursuant to this code, that would be affected particularly or significantly by government actions in which they participate.
Public interest	On appointment to office, and thereafter, public office holders shall arrange their private affairs in a manner that will prevent real, potential, or apparent conflicts of interest from arising, but if such a conflict does arise between the private interests of a public office holder and the official duties and responsibilities of that public office holder, the conflict shall be resolved in favour of the public interest.
Gifts and benefits	Public office holders shall not solicit or accept transfers of economic benefit, other than incidental gifts, customary hospitality, or other benefits of nominal value, unless the transfer is pursuant to an enforceable contract or property right of the public office holder.
Preferential treatment	Public office holders shall not step out of their official roles to assist private entities or persons where this would result in preferential treatment to any person.
Insider information	Public office holders shall not knowingly take advantage of, or benefit from, information that is obtained in the course of their official duties and responsibilities and that is not generally available to the public.
Government property	Public office holders shall not directly or indirectly use, or allow the use of, government property of any kind, including property leased to the government, for anything other than officially approved activities.
Post-employment	Public office holders shall not act, after they leave public office, in such a manner as to take improper advantage of their previous office.
Fundraising	Public office holders are not to personally solicit funds from any person, group, organization, or corporation where such fundraising could place public office holders in a position of obligation incompatible with their public duties.

Source: Privy Council Office

Strengthening the audit committee

7.79 As the audit committee is the board committee responsible for oversight of financial controls and disclosure, regulators' and stakeholders' expectations of the audit committee have increased in the last few years, and so has the committee's role.

7.80 Canadian securities regulators recently issued, in multilateral instrument 52-110, requirements for practices that audit committees of publicly traded companies are to follow. These requirements are generally consistent with the best practices we identified for Crown corporations in 2000. However, in a few areas, they go beyond what is expected from audit committees of Crown corporations.

7.81 Independence. All members of audit committees are now expected to be independent. This goes well beyond the governance regime of Crown corporations: the *Financial Administration Act* currently requires only that the majority of audit committee members not be members of management or employees of the corporation. Regulators have defined independence for audit committees generally to mean no direct or indirect material relationship with the company. Those prohibited from sitting on the audit committee are current or recent employees or executives of the company, family members of current or recent executives, and partners or employees of the external or internal auditor (or auditors who recently filled the positions). There are also restrictions on compensation for services other than acting as a member of the board.

7.82 Most Crown corporation audit committees have a membership that reflects these expectations. In our view, however, the full independence of audit committees needs to be clearly required in policy or in legislation.

7.83 Approval of financial disclosure. Regulators require audit committees to review financial statements, and the management discussions and analysis associated with the statements, before their release. Audit committees must also ensure that adequate procedures are in place for the review of any other financial information to be released by the corporation. Further, audit committees are expected to establish procedures for dealing with complaints or concerns, including those made anonymously, about accounting, internal accounting controls, and audit matters.

7.84 We noted that the audit committees of Crown corporations review, discuss, and approve annual financial statements. However, the review of other key information being disclosed in the annual report or in other public documents is uneven and usually less rigorous. As the demand for better reporting and disclosure increases, these requirements will become increasingly important for audit committees.

7.85 Handling complaints and concerns. Finally, the introduction of "whistle-blowing" mechanisms in Crown corporations is still at an early stage. Currently, some audit committees have implemented, or are considering implementing, procedures to handle complaints or concerns from interested parties. The government has introduced legislation in the House of

Commons pertaining to “whistle blowing” in the public service, which will also apply to Crown corporations.

Strengthening expectations of management

7.86 While recent developments in corporate governance have focussed on the board, more is expected of management in a number of areas. In particular, legislators and regulators in the United States and Canada have been requiring management of publicly traded corporations to take personal responsibility for financial disclosure and for the internal controls of the organization. This responsibility is in the form of a public certificate that must be supported by evidence that controls are properly designed and working effectively. Regulators in Canada are currently considering if there is a need for the certificate to be supported by the attestation of the external auditor.

7.87 However, the Crown corporation environment has not experienced the same financial reporting issues that led regulators to require public certification in publicly traded companies. Therefore, we are not presently suggesting that a similar requirement be applied to Crown corporations. Current literature on this subject shows that the cost of implementing a certification process is significant. It is important that any consideration by the government to introduce a similar requirement for Crown corporations include an assessment of the costs and potential benefits of such a measure. Any certification requirement also needs to be tailored to the public sector environment.

Disclosure and reporting—closing the accountability cycle

7.88 We did not examine disclosure and reporting in our 2000 audit of governance in Crown corporations. However, in previous audits and studies we have noted repeatedly that Crown corporations need to improve the quality, timeliness, and completeness of the accountability information in their annual reports.

7.89 In the private sector, expectations for transparency and disclosure of financial and non-financial information have risen significantly for publicly traded companies. In the public sector, there have also been a number of initiatives to enhance public disclosure. Many of these developments could be adapted for federal Crown corporations to improve their disclosure practices.

7.90 Disclosure requirements of publicly traded companies have generally been more rigorous than those required of private companies or public sector corporations. Securities regulators in Canada and the United States have emphasized that managers of publicly traded companies must take more personal responsibility for the financial and non-financial information that they produce and disseminate.

7.91 Management discussion and analysis of performance. As part of the regulatory disclosure requirements, all companies are to include in their annual reports a management discussion and analysis (MD&A) of the company’s financial condition, the results of its operations, and its cash flows. The analysis must include a comparison with the company’s performance of

the previous year. Regulators also require publicly traded companies to disclose their business risks and their key environmental and social policies.

7.92 The purpose of the MD&A is to give users of the financial statements the underlying information on, and reasons for, the reported performance and allow them to understand future trends. Recent guidance by the Canadian Performance Reporting Board of the Canadian Institute of Chartered Accountants (CICA) on MD&A describes accepted practice for these types of disclosure. While its guidance was written primarily for companies that are subject to oversight by securities regulators, the CICA indicated that public sector and non-profit organizations could also use it.

7.93 Reporting on performance against public policy objectives. Crown corporations have public policy objectives in addition to any commercial objectives. In our review of Crown corporations' annual reports for the Auditor General's Award for Excellence in Annual Reporting, we have found consistently that many Crown corporations fail to state their public policy objectives and evaluate their performance against them. For example, in 2003 we found that more than half of the Crown corporations did not report how they had performed in meeting their public policy objectives. With the recent guidance from the CICA on MD&A, we expect that analysis of the factors contributing to the achievement of commercial and public policy objectives will improve.

7.94 Expanding access to information. Presently, 28 Crown corporations are subject to the *Access to information Act*. The government's Access to Information Review Task Force in 2002 made a number of recommendations that could affect Crown corporations. In particular, the Task Force recommended that criteria be established to determine which institutions should be covered by the *Access to Information Act*. One set of suggested criteria would have the Act apply to any institution that has a majority of board members appointed by the government, receives all its financing through appropriations, or has its controlling interest owned by the government. Another suggested criterion would include institutions that perform functions in an area of federal jurisdiction related to health and safety, the environment, or economic security. The Task Force recommended that exceptions to these criteria be allowed where access to information would be incompatible with the institution's structure or mandate. We understand that the Treasury Board Secretariat's review of Crown corporation governance will address this issue.

7.95 Making special examination reports public. With some exceptions, Crown corporations are required to have a special examination conducted at least once every five years. In March 2004, the government announced its intention to have the reports on these examinations made public and tabled in Parliament. However, there is currently no formal requirement to do so. We have issued eight special examination reports since the government announcement in March. At the time of writing this chapter, four Crown corporations had posted their examination reports on their Web sites. In our view, the tabling of special examination reports in Parliament would assist

parliamentarians in their oversight role for Crown corporation activities and performance. The Treasury Board Secretariat's review of Crown corporation governance is also addressing this matter.

7.96 Corporations in both the private and public sectors are being required to improve the quality and increase the quantity of public disclosure. Improved reporting in annual reports and other forms of public disclosure are expected by regulators and required from other public sector entities. These will help to ensure the transparency of operations and help stakeholders hold boards and management to account.

Conclusion and Recommendations

7.97 Overall, progress in addressing the recommendations from our 2000 audit of Crown corporation governance has been unsatisfactory. Individual Crown corporations have strengthened their own governance structures and practices. However, improvements that we recommended to strengthen the overall governance and accountability framework have not progressed as quickly and as far as we had expected.

7.98 Still, we found fewer gaps in the collective skills and expertise of board members. We also found that the composition and operating practices of board audit committees had improved and that audit committees are operating more effectively than in 2000.

7.99 Indications that governance practices have either not improved or improved slowly include the following:

- Only in 2004 did the government start addressing some of our key 2000 recommendations.
- A revised process for appointing Crown corporation boards of directors, chairs, and chief executive officers (CEO) was announced in March 2004 but has not yet been fully defined and implemented.
- It takes too long to appoint board members, chairs, and CEOs. Many board members' terms have expired. Some large Crown corporations are without permanent CEOs.
- The terms of board members are not evenly staggered, increasing the risk that corporate memory will be lost.
- The government has still not assessed the skills and abilities that it needs to review corporate plans and ensure the continued relevance of Crown corporation mandates.
- The responsibilities and expectations of the government regarding Crown corporations still need to be clarified.

7.100 Our recommendations from 2000 to improve the governance of Crown corporations continue to be relevant and valid today, and our review of practices outside the government shows that expectations continue to increase.

7.101 Recommendation. As the government establishes new expectations for good governance practices for Crown corporations, it should

- clarify the relationship between the board and the responsible minister and other representatives of the government;
- ensure that the government's expectations of the corporation are formally, clearly, and publicly communicated;
- effectively implement the revised appointment process for directors, chairs, and chief executive officers, paying particular attention to the timeliness and proper staggering of appointments;
- update current governance structures and practices to reflect best practices for the composition, roles, and responsibilities of boards and audit committees, including
 - reassessing the appropriateness of having public sector directors on boards,
 - reassessing independence requirements for members of audit committees, and
 - assessing the costs/benefits of implementing a certification process for internal control; and
- update current expectations for disclosure, reporting, and transparency to reflect best practices in private and public sectors.

7.102 Recommendation. In updating their board mandates and governance structures and practices to reflect best practices, boards of directors should

- ensure that directors have access to continuing education;
- develop/review their values and ethics programs and infrastructure to reflect the principles underpinning the new *Values and Ethics Code for the Public Service*;
- ensure that they assess their collective effectiveness as well as the contribution of each member;
- ensure that audit committees review and recommend to the board information that will be disclosed in annual reports and other public documents; and
- ensure that mechanisms are put in place to deal with complaints and concerns from interested parties.

Government's response. The government remains committed to improving the governance of Crown corporations. Many of the issues identified in this report are being examined in the context of the government's review of Crown corporation governance. We believe that the review will respond to the measures recommended in your report.

Crown corporations' responses. It is not practical to obtain the responses of 43 Crown corporations to the recommendations that apply to them directly. However, we did discuss our findings and recommendations with the chairs and/or CEOs of seven Crown corporations. Generally, they supported the main messages of the chapter and agreed with the recommendations directed specifically at Crown corporations.

About the Follow-Up

Objectives

The objectives of this follow-up were to assess the extent of the action taken by the government and Crown corporations to address our recommendations in our December 2000 Report, Chapter 18, Governance of Crown Corporations, and the December 2002 audit observation on executive compensation. We also wanted to determine the potential implications of recent developments in corporate governance on the governance and accountability framework of Crown corporations.

Scope and approach

Our follow-up work focussed on the main issues raised in our December 2000 Report and the related 2002 report of the House of Commons Standing Committee on Public Accounts and in our December 2002 audit observations.

We reviewed current developments in corporate governance in Canada and elsewhere. Based on our Office's past and current work on Crown corporations, we assessed whether changes were needed to strengthen the legislative framework for Crown corporation governance and accountability, and reflect current best practices in Canada and elsewhere.

We reviewed the process for appointing board members and the effectiveness of audit committees in 14 Crown corporations. We also interviewed staff at the Privy Council Office, Treasury Board Secretariat, and in federal departments. We interviewed chief executive officers (CEO), board and audit committee chairs, and corporate secretaries; reviewed files and management reports; and analyzed data. Finally, given that the Auditor General is the statutory auditor of most Crown corporations, we used a combination of document review and our own observations to assess the effectiveness of audit committees.

Criteria

We expected that the Government of Canada would have made satisfactory progress in addressing our recommendations. We used the audit criteria we had used in 2000, which are still relevant. That is, we expected that to protect the shareholder's interest, to ensure that Crown corporations achieve their public policy objectives effectively and efficiently, and to optimize their commercial objectives,

- there should be timely appointments of qualified board chairs, CEOs, and board directors that meet the requirements of the government and the corporation and that strengthen the accountability relationships among the board, the CEO, and the government;
- audit committees should be constituted with appropriate skills and experience, carry out necessary roles and responsibilities, and perform their duties effectively, as measured against best practices;
- the government should conduct a robust review and challenge of a corporation's corporate plan as the basis for the plan's approval; and
- there should be assurance that the mandate of each corporation, including its public policy and financial objectives, continues to be relevant.

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Appendix A Status of the government's action to address recommendations made by the Public Accounts Committee in its Report on Chapter 18 of the December 2000 Report of the Auditor General of Canada

Recommendation	Status
That Treasury Board Secretariat (TBS) assess departmental capacity to review and challenge corporate plans of their respective Crown corporations. Once the assessment is completed, that a report be prepared identifying the areas where departmental review capacity needs strengthening, describing the initiatives required to upgrade departmental systems and practices, together with a timetable for implementation.	Assessment not completed by TBS and no report produced (see paragraph 7.52).
That Treasury Board Secretariat, when receiving the corporate plan for review and recommendation, request from the Crown corporation a copy of the most recent special examination report.	Special examination report to be available on Crown corporation Web site (see paragraph 7.95).
That Treasury Board Secretariat and the Department of Finance execute an assessment of their own capacity to review and challenge corporate plans. Once the assessment is completed, that a report be prepared identifying the areas where review capacity needs strengthening, describing the initiatives required to upgrade systems and practices, together with a timetable for implementation.	Assessment not completed by TBS and Department of Finance; no report produced (see paragraph 7.52).
That each Crown corporation review and amend its selection criteria and procedures for establishing the membership of its audit committee in order to ensure that all its members are financially literate and further ensure that at least one member possesses the required knowledge and experience in financial management and accounting.	Implemented (see paragraphs 7.43 and 7.44).
That the Privy Council Office provide assistance to Crown corporations in developing board skills profiles and ensure that these profiles are submitted in timely fashion to the responsible minister and the Prime Minister's Office.	Implemented (see paragraph 7.25).
That the government and the responsible ministers of Crown corporations take into consideration the skills profiles of candidates when selecting and appointing board chairs and directors.	Some progress, at March 2004 (see paragraphs 7.17, 7.25, and 7.27). Revised appointment process being implemented (see paragraphs 7.33 to 7.38).
That the government consider developing a formal mechanism or process that would permit a systematic review of a Crown corporation's mandate, executed on a ten-year basis or when significant changes to government policy or to the economic environment occur that impact on the relevance of the Crown corporation's mandate.	Not implemented (see paragraph 7.54).
That the government review and amend the process of appointing directors and chief executive officers (CEOs) to Crown corporations in order to ensure greater involvement of the Crown corporation's board of directors in recommending potential candidates to the Governor in Council.	Revised process being implemented (see paragraphs 7.33 to 7.38).
That the government prepare a transitional strategy that would allow certain Crown corporation boards the opportunity to build up the required capacity to conduct effective candidate searches for recommendation to the Governor in Council.	Revised process being implemented (see paragraphs 7.33 to 7.38).
That the government evaluate the practicality of applying best practices found in other countries or jurisdictions for appointing senior officers to public sector or government-owned corporations. That the government prepare a report containing recommendations based on the best practices.	Completed; report prepared by the Privy Council Office. Revised process being implemented (see paragraphs 7.33 to 7.38).

Appendix B Appointment process for senior executives of Crown corporations

Nominating committee

The board of directors must establish a nominating committee to identify candidates for the positions of CEO, chairperson, and directors. This committee may include outside eminent persons. In undertaking its work, the nominating committee will need to rely on rigorous processes involving the use of a professional recruitment firm, where appropriate, as well as public advertisements for the selection of the CEO and chairperson. In particular, it will have to develop selection criteria for the CEO and chairperson, as well as a competency profile for the board as a whole. In the case of the CEO and chairperson, the positions would normally be advertised in the *Canada Gazette* and national newspapers. For all positions, including those of directors, the nominating committee will normally seek the assistance of an executive search firm.

Selection criteria for CEO and chairperson

The selection criteria for the CEO and chairperson should consist of the following elements: education, experience, knowledge, abilities, and personal suitability required for the position. Abilities could include characteristics such as corporate vision, leadership, and the ability to communicate effectively with stakeholders. Personal suitability could include attributes such as ethical character and sound judgment.

Board competency profile

For directors, a board competency profile should be developed. This is a description of the experience, attributes, and skills that should be possessed by the board as a whole. This profile will be based on the roles and responsibilities of the board, and may include a set of generic attributes that all board members must have, such as adaptability, sound judgment, collegiality, and financial acumen, as well as specific attributes such as knowledge of the industry. The profile should also recognize the need for the board to be representative of the Canadian population and of Canada's geographic regions. Additional information on how to build a director's competency profile can be found on the Privy Council Office Web site.

Director's skills profile

In filling a director's position, the nominating committee will want to assess the skills of those already on the board. Having done this, and taking into consideration the board profile, the committee can identify the specific competencies required to complete the skills mix for the board as a whole.

Agreement on selection criteria and board profile

Once selection criteria and board competency profiles have been completed, these will need to be discussed with the responsible minister's office, the director of appointments in the Prime Minister's Office, and the Senior Personnel and Special Projects Secretariat of the Privy Council Office.

Responsible minister's review of candidate list

Once a list of suitable candidates for the positions of CEO, chairperson, and director has been developed by the nominating committee using the approach above, it will be submitted to the board of directors, who will provide a short list of candidates to the minister responsible for the corporation. Based on this list, the minister will make a recommendation for appointment. The appropriate parliamentary committee may then review the candidate recommended by the minister.

Re-appointments

In the case of re-appointments, the nominating committee will want to assure itself that the individual has the competencies required for the position. This being the case, the name of this individual will be submitted to the responsible minister who will make a recommendation for re-appointment. The appropriate parliamentary committee may then review the candidate recommended by the minister.

Additional information

Additional information on these processes can be obtained from the Senior Personnel and Special Projects Secretariat of the Privy Council Office, which will also be responsible for the placement of advertisements in the *Canada Gazette*.

Source: The Treasury Board of Canada

Appendix C Selected best practices for audit committees

Best practices since 2000 are highlighted in blue

The audit committee should ensure financial oversight by

- critically reviewing the interim and annual financial statements, the auditor's report, and the management discussion and analysis section of the annual report;
- ensuring that presentation of financial statements is fair, appropriate, and clear, and that it meets generally accepted accounting principles; and
- actively soliciting the external auditor's judgments about the acceptability and the quality of the corporation's accounting principles as applied in its financial reporting. This discussion should include such issues as the clarity of financial disclosure and the aggressiveness or conservatism of the corporation's accounting principles and estimates.

The audit committee should ensure oversight of corporate books, records, financial and management control and information systems, and management practices by

- reviewing the special examination plan and report prepared by the external examiner;
- actively soliciting information about significant risks and exposures and reviewing the adequacy of internal controls to manage those risks;
- reviewing the integrity and effectiveness of the management information systems;
- reviewing internal audit plans and reports and management's subsequent actions; and
- reviewing significant findings and recommendations made by the external auditor and examiner and following up on management's subsequent actions.

The audit committee should

- ensure ethical oversight through the annual review of management's compliance with the corporate code of conduct;
- actively solicit all sensitive information (for example, senior management expenses, significant litigation, non-compliance with laws and regulations, misuse of corporate assets, illegal activities);
- oversee the resolution and investigation of complaints of wrongdoing (audit committee mandates should include the requirement for a process to investigate and resolve all complaints, including those made anonymously);
- ensure that internal audit is adequately resourced and that it has adequately covered the major risks and activities of the corporation; and
- recommend external auditors and their compensation, and pre-approve all non-audit services by external auditors to ensure that their objectivity and independence are preserved.

Membership and competencies

- Audit committees should be composed of at least three members. Each member should be an independent director, who should not be an officer or an employee of the corporation.
- Although a variety of skills and experience is beneficial to an effective and balanced audit committee, all members should be financially literate and at least one member should have accounting or related financial management expertise. Financial "literacy" signifies the ability to read and understand fundamental financial statements, including a balance sheet, income statement and cash flow statement, and the ability to ask probing questions about the corporation's financial risks and accounting. "Expertise" signifies past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication (experience as a chief executive officer, for example, or other senior officer with financial oversight responsibilities).

Operating procedures

Terms of reference. Audit committees should have clear, written terms of reference and operating procedures that specify the scope of the committee's responsibilities and how it carries them out, including its structure, processes, and membership requirements.

Meetings. The frequency of audit committee meetings should be tailored to the responsibilities assigned, but should be at least quarterly. The audit committee should also meet periodically with management, the external auditor, and the head of internal audit, in separate private sessions.

Disclosure requirements

Audit committees should publicly disclose their charter, composition, recommendations not adopted by the board, and nature and amounts of auditor's fees, in audit and non-audit services.

