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Governance Study**

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# auditor general's comments

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Over the last several years there has been a growing recognition that the way in which governance responsibilities are discharged has a significant impact on the performance of organizations in both the private and public sectors. There is also growing agreement that the way governance matters are dealt with generally needs to be improved.

The Province's Crown corporations provide services that are important to British Columbians. They generate and deliver electrical power, insure vehicles, supply transportation, and provide a range of other services. These organizations are established as corporations, as distinct from ministries, because in providing these services they pursue business objectives that require them to operate using sound commercial business practices and to be separate

from some of the constraints that apply to ministries of government. At the same time, they are part of the public sector because they also pursue public policy goals. This simultaneous pursuit of both commercial and public policy goals creates significant governance challenges for Crown corporations.

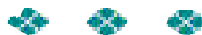
Because the relationship of Crown corporation boards and management to government, its agencies, and the Legislative Assembly is important to the success of the organization and is, at the same time, complex and often difficult to manage, my Office decided to examine the governance relationships and practices that exist in British Columbia. Considerable thought has been devoted to governance issues recently in various public forums, and we wanted to see whether the concepts developed in these forums had application in British Columbia and could be used to improve practices here.

I believe this report will be useful to all parties involved in Crown corporation governance, as it sets out the practices others have found helpful and identifies areas where there are opportunities to improve Crown corporation governance in this Province. Given the size and importance of the Crown corporation sector in British Columbia, good

corporate governance which contributes to good corporate performance is vital to the effective performance of government as a whole.

*George L. Morfitt, FCA  
Auditor General*

*Victoria, British Columbia  
November 1996*



# highlights





# highlights

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Governance is the authoritative direction or control over an entity. In a corporate setting it encompasses the roles, relationships, powers, and accountability of shareholders, the board, and management. Governance refers to: who is in charge, who sets direction, who makes decisions, who monitors progress, and who is accountable for the performance of the corporation.

Good governance of a Crown corporation assumes that responsibility for acting in the public interest will be clearly assigned and accountability for discharging that responsibility will be clearly laid out.

The law generally confers to a board of directors the responsibility to direct and control the affairs of the corporation—that is, to govern. The board is generally expected to report annually on the corporation's performance.

## Purpose and Scope of the Study

Crown corporations play an important role in the economic and social fabric of the province and are involved in many sectors of the economy. The governance of these corporations is complex and the roles and responsibilities of the parties involved in the governance process are often difficult to understand at all levels. The purpose of our study was to identify the broad governance issues relating to Crown corporations, document current governance structures and processes in Crown corporations in the Province, and thereby provide a common base of information to assist government and its agencies in determining improvements that may appropriately be made to current governance processes. The issues we examined were selected by considering practices in other jurisdictions and reviewing governance-related studies carried out in both the public and private sectors.

Our study focused on broad governance issues related to the responsibilities, authorities, accountabilities, and relationships defined for the various entities involved in the governance of Crown corporations in the Province, as well as on the specific practices that boards follow to fulfill their role of supervising the affairs of Crown corporations.

We carried out our study during the spring of 1996. The study focused mainly on the 10 major Crown corporations of the Province and included information obtained from four main sources: literature, existing documents, interviews, and

a survey of directors. We also reviewed numerous documents specifically concerned with governance in British Columbia, such as general and enabling legislation, central agency and government guidelines on mandate and roles, board manuals and guidelines, and management and consultants' reports.

## Conclusion

Our study indicates there is a great deal of interest in Crown corporation governance in British Columbia, and that the governance challenges in British Columbia are similar to those faced in other jurisdictions. We also found there is general agreement among those involved in Crown corporation governance in the Province that the current system could be improved. Clearly British Columbia can both learn from and apply the lessons learned elsewhere to make governance in Crown corporations better.

What is needed is a governance model for Crown corporations that meets the requirements of the Legislative Assembly, government, and boards in a way that balances accountability expectations with the boards' need for sufficient independence and flexibility to carry out their responsibilities.

We also believe that Crown corporation boards could benefit from studying and applying some of the recent developments taking place in both the private and public sectors to improve the effectiveness of boards.

## Key Observations

### Corporate Governance

The governance of Crown corporations is complex, involving a number of governance agents in an environment that seeks to accomplish both commercial-type objectives and public policy objectives in an efficient and effective manner. Shared decision-making creates unique challenges for many corporations. Boards operate in an environment where it is sometimes unclear as to what roles the Minister, board, chief executive officer, and central agencies are each to play. A common view is that government should help set the direction for the corporation but leave operational decision-making to management.

Recently there have been a series of authoritative articles and pronouncements providing guidance to the governance level of corporations in both the private and public sectors. This guidance was initially concerned with helping private sector boards discharge their responsibilities more effectively; however, scrutiny has now spread to the public sector where there is a strong awareness of governance-related issues.

British Columbia faces the same challenges regarding Crown corporation governance as those faced by other jurisdictions. Currently there is no one source for defining the roles, responsibilities, and accountability of those involved in the governance of Crown corporations in the Province. Corporations are generally set up by their own legislation; however, there is variability in the definition of the roles of those involved in governance of Crown corporations. We found confusion as to the obligations, rights and authorities of governance agents. Resolving the uncertainties and ambiguities of roles will be a major step in improving the governance environment in Crown corporations.

Another area where improvements could be made is in providing more clarity on how and when the government provides direction to Crown corporations. Currently boards face significant challenges when they try to integrate public policy objectives into their operations. Legislation does not always provide them with clear direction. Board members generally look to the Minister responsible for the corporation however, with the frequent changes in ministers and in policy direction, getting consistent messages can be a challenge. Much of the direction Crown corporations receive currently is at times ad hoc and reactive, and usually occurs informally through contact between the Minister and the chair of the corporation.

There are different types of Crown corporations in the Province. They have not been formally classified but are generally described as commercial, economic development, and social and government services. The level of interest and concern of government and the Legislative Assembly regarding the different types of Crown corporations varies. At one end of the spectrum, government can exercise a high degree of control over a Crown corporation by reviewing all budgets and approving all decisions—a heavy focus on the input side, with involvement before decisions are carried out. At the other end, government can set broad expectations and focus on accountability—having boards account for their performance. Most Crown corporations want government to approve their corporate plan in a timely manner, to let them operate with relatively little interference, and to hold them to account for their performance against plans.

The government has a number of central agencies that are involved in overseeing the activities of Crown corporations. These agencies provide support to Cabinet, Cabinet committees, the Minister responsible, and the Minister of Finance and Corporate Relations. Although coordination of activities between the various agencies has steadily improved, better coordination is needed to ensure that oversight activities are carried out and that duplication is avoided.

There is no legislated provision establishing an oversight role by the Legislative Assembly. The Public Accounts Committee in its 1996 report on *Enhancing Accountability for Performance in the British Columbia Public Sector* recognizes that the interaction between legislative and governmental systems must work together more effectively if there is to be an improved accountability and governance regime.

We believe there are opportunities to provide greater clarity in both governance and accountability in regard to Crown corporations, as the provisions of the accountability framework recently proposed for government in *Enhancing Accountability for Performance: A Framework and Implementation Plan*, issued jointly by the Auditor General and the Deputy Ministers Council in April 1996, are implemented. Many initiatives relating to good governance are already underway or proposed for implementation. These include:

- development of strategic plans for Crown corporations;
- development of high-level, comprehensive performance measures;
- intent to publish Crown corporation plans; and
- intent to publish an annual report summarizing the performances of all Crown corporations.

Because Crown corporations are creatures of the Legislature, fulfilling a mandate set in legislation, it is the responsibility of the Legislative Assembly to ensure that the mandate is appropriately discharged. The government has recently established a Legislative Assembly Committee for Crown corporations to help the Assembly in fulfilling this role. However the specific terms of reference for the committee have not yet been established.

## Board Governance

We noted that changes are also underway at the board level within Crown corporations. We found that boards are generally aware of some of the governance initiatives underway and have started to adopt current concepts into their governance structures and practices. Boards are interested in ensuring that their compositions are appropriate to the corporations' needs and some have started to evaluate their own performance. Through the accountability framework, boards will have greater opportunity to receive effective governance information.

Board members in British Columbia recognize that they have some common issues to deal with, in particular regarding their relationship to the Legislative Assembly, government and its agencies. We encourage their active participation in the development of clearer definitions of board roles and responsibilities.

## Recommendation

Since there are different models that can be applied to the governance of Crown corporations, depending on the level of oversight desired by the Legislative Assembly and the government, we do not make any detailed recommendations in this report. Rather we provide our observations and findings on the critical governance issues so as to assist the government in examining this important area, and make a general recommendation.

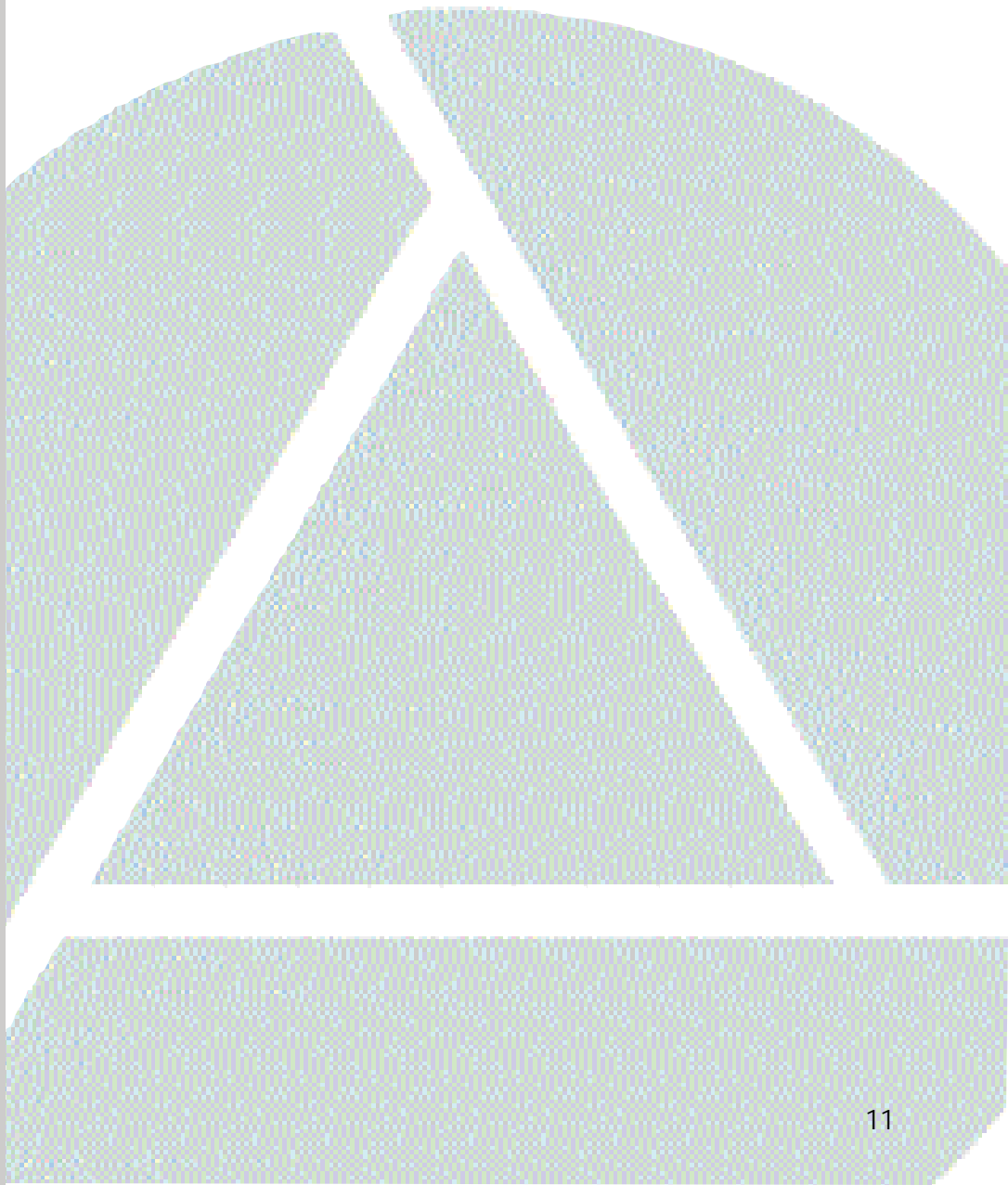
***We recommend that the government review the current system of Crown corporation governance and develop a model that:***

- ***is based on the principles and values of the government;***
- ***clearly establishes the respective roles and responsibilities of all those involved in Crown corporation governance;***
- ***provides the flexibility needed by the boards to carry out their duties; and***
- ***is based on the degree of independence the government and Legislative Assembly wish to be accorded to Crown corporations.***





# detailed report







## background

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### What are Crown Corporations?

There is no single definition for a Crown corporation. In British Columbia, the *Financial Administration Act* (FAA) defines a government corporation as a corporation that is an agent of the Crown under an act and in which the government either holds, directly or indirectly, more than 50% of the voting shares, or has control by virtue of appointing a majority of the board of directors.

Crown corporations are set up by governments to pursue public policy goals. In serving the public interest, they are expected to operate in a commercial manner and are provided with a higher degree of autonomy than the rest of government. They are generally viewed as being appropriate for programs that:

- focus mainly on a business or commercial interest;
- generate revenue, varying in amounts up to self-sufficiency;
- involve large numbers of transactions with members of the public;
- require greater flexibility than is available under the ministry model; or
- require decision-making that is more removed from government than ministries.

A Crown corporation can own and sell property in its own name and initiate legal actions under its name; it tends to be more independent of government than a ministry and may not be subject to the same administrative policies;

and, like a private sector company, it has a board of directors. The federal government chooses the Crown corporation model over the ministry model whenever it decides there is the need for the use of sound commercial business practices and a clear separation of the government from day-to-day management activities.

Governance differs between Crown corporations and government ministries. Heads of ministries are accountable to their Ministers and thus to the Legislative Assembly. Heads of Crown corporations are accountable to both the Minister responsible for the corporation and a board of directors, the latter having a duty to “supervise the management of the affairs of the corporation.” This addition of a board of directors results in a greater sharing of governance responsibilities.

In an environment where governance roles are split between the Legislative Assembly, government, and a board, it is paramount that the respective roles, decision-making authorities, and accountabilities be clear.

### Crown Corporations in British Columbia

At the start of our study there were 28 Crown corporations in British Columbia. These corporations controlled more than \$28 billion in assets, annually generated about \$9.5 billion in revenues, and incurred some \$8.6 billion in expenditures. In addition, they owed more than half of the provincial debt which totals about \$28.8 billion.

The provincial government has divided Crown corporations into three groups: commercial, economic development, and social and government services. Exhibit 1 lists the 28 Crown corporations by group.

Commercial Crown corporations are those which are

self-supporting, generating enough revenue to meet their operating expenses and requiring no contributions from government. Economic development Crown corporations generate revenues that substantially but not fully cover their operating expenses, so they receive grants or other financial

## Exhibit 1

### Allocation of Crown Corporations by Category

#### Commercial

British Columbia Hydro and Power Authority\*  
 British Columbia Lottery Corporation\*  
 British Columbia Railway Company\*  
 Insurance Corporation of British Columbia\*

#### Economic Development

British Columbia Community Financial Services Corporation  
 British Columbia Ferry Corporation\*  
 British Columbia Pavilion Corporation\*  
 British Columbia Rapid Transit Company Ltd.  
 British Columbia Transit \*  
 British Columbia Trade Development Corporation\*\*  
 British Columbia Transportation Financing Authority  
 Columbia Power Corporation  
 Duke Point Development Limited  
 Forest Renewal BC  
 Okanagan Valley Tree Fruit Authority  
 Victoria Line Limited  
 W.L.C. Development Ltd.

#### Social and Government Services

British Columbia Assessment Authority\*  
 British Columbia Buildings Corporation\*  
 British Columbia Educational Institutions Capital Financing Authority  
 British Columbia Housing Management Commission  
 British Columbia Regional Hospital Districts Capital Financing Authority  
 British Columbia School Districts Capital Financing Authority  
 British Columbia Systems Corporation\*\*  
 First Peoples' Heritage Language and Cultural Council  
 Pacific National Exhibition  
 Provincial Capital Commission  
 Provincial Rental Housing Corporation

\*Included in the study.

\*\*Included in the study initially but dissolved before study completed.

assistance from government. Social and government services Crown corporations depend to a large extent on government funding to meet operating or debt servicing needs.

Crown corporations play an important role in the economic and social fabric of the Province and are involved in most sectors of the economy. Some, such as the British Columbia Hydro and Power Authority and the Insurance Corporation of British Columbia, affect almost the entire population of the province. Others, such as the Okanagan Valley Tree Fruit Authority and First Peoples' Heritage, Language and Cultural Council, affect a more targeted population. Still others, such as the British Columbia Buildings Corporation, mainly serve the government. Several new Crown corporations have been established (for example Forest Renewal BC) and others have been dissolved as the need for them passed (for example, the British Columbia Hazardous Waste Management Corporation).

## Governance Initiatives

Over the past decade, there has been growing awareness of the need to increase efforts to improve corporate governance. Following financial collapses and difficulties that affected a number of companies in Canada and the United States in the 1980's, a number of new pronouncements were made to address the concerns of different regulatory bodies about weaknesses in governance.

Much of this work (such as the *Financial Aspects of Corporate Governance*, referred to as the *Cadbury Report* [United Kingdom, 1992] and the *Committee of*

*Sponsoring Organizations of the Treadway Commission Report* [United States, 1994]) focused on helping private sector boards define and discharge their responsibilities more effectively. As well, the Toronto Stock Exchange (TSE) published *Where were the Directors: Guidelines for Improved Corporate Governance in Canada* (1994), which now requires corporations trading on the TSE to include their corporate governance practices in their annual reports. The Canadian Institute of Chartered Accountants published a report, *Guidance for Directors—Governance Processes for Control* (1995), setting out what directors should consider about the corporate control systems on which they rely. Additional governance studies have also been completed or are underway in several other foreign jurisdictions.

Concerns about governance have not been restricted to the private sector. Public sector corporations have also been subject to scrutiny. The Department of Finance and Treasury Board of Canada in collaboration with the Conference Board of Canada and the Canadian Centre for Management Development in 1993 published a guide, *Directors of Crown Corporations: An Introductory Guide to their Roles and Responsibilities*. CCAF-FCIV Inc. in 1994 issued its *Six Characteristics of Effective Governance*, and in 1995 the Auditor General of Canada released *Crown Corporations: Fulfilling Responsibilities for Governance*. Some provincial audit offices have also reported on governance-related issues.

Clearly, efforts to improve governance in different sectors of the economy have become widespread and have attracted the attention of a number of authoritative bodies.

## Practices in Canada

The actual structures and processes used in the governance of Crown corporations vary across Canada. Even where similar structures are used, the processes may vary. Government, in its relationship with Crown corporations, can set up a system that either gives them considerable autonomy or provides for strong central control over them.

There are two basic models used: the Federal model (Exhibit 2) and the Saskatchewan model (Exhibit 3).

Exhibit 2 shows the structure used by most Canadian jurisdictions. Responsibilities for each Crown corporation are generally allocated

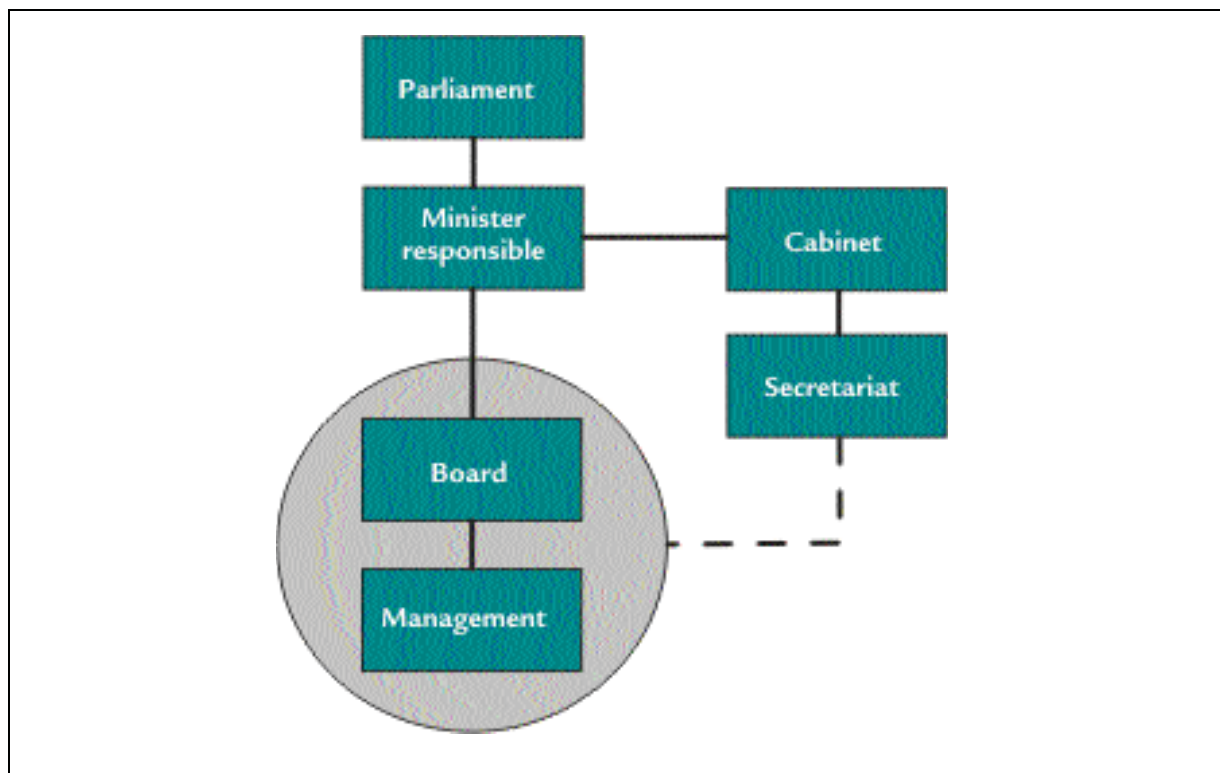
to an assigned Minister, Cabinet, central agencies, and the board of the corporation.

In the Saskatchewan model, the main feature is a government-owned holding company, the Crown Investments Corporation, which is responsible for managing and coordinating subsidiary commercial Crown corporations. The board of this holding company consists of a number of ministers. Crown corporations not set up as subsidiaries under the Crown Investment Corporation are under the direction of Treasury Board. These are generally non-commercial Crown corporations.

Whichever model is applied, the actual processes used by government to interact with the

### Exhibit 2

#### Federal Model of Crown Corporation Governance



Crown corporations can result in a range of relationships, varying from a very autonomous relationship to a very control-oriented one. Between these extremes, autonomy is balanced with control so that the shareholders and boards both understand each other's roles, rights, and obligations and are satisfied with the arrangement.

Factors such as involvement in strategic decision-making, clarification of objectives, performance evaluation, operational

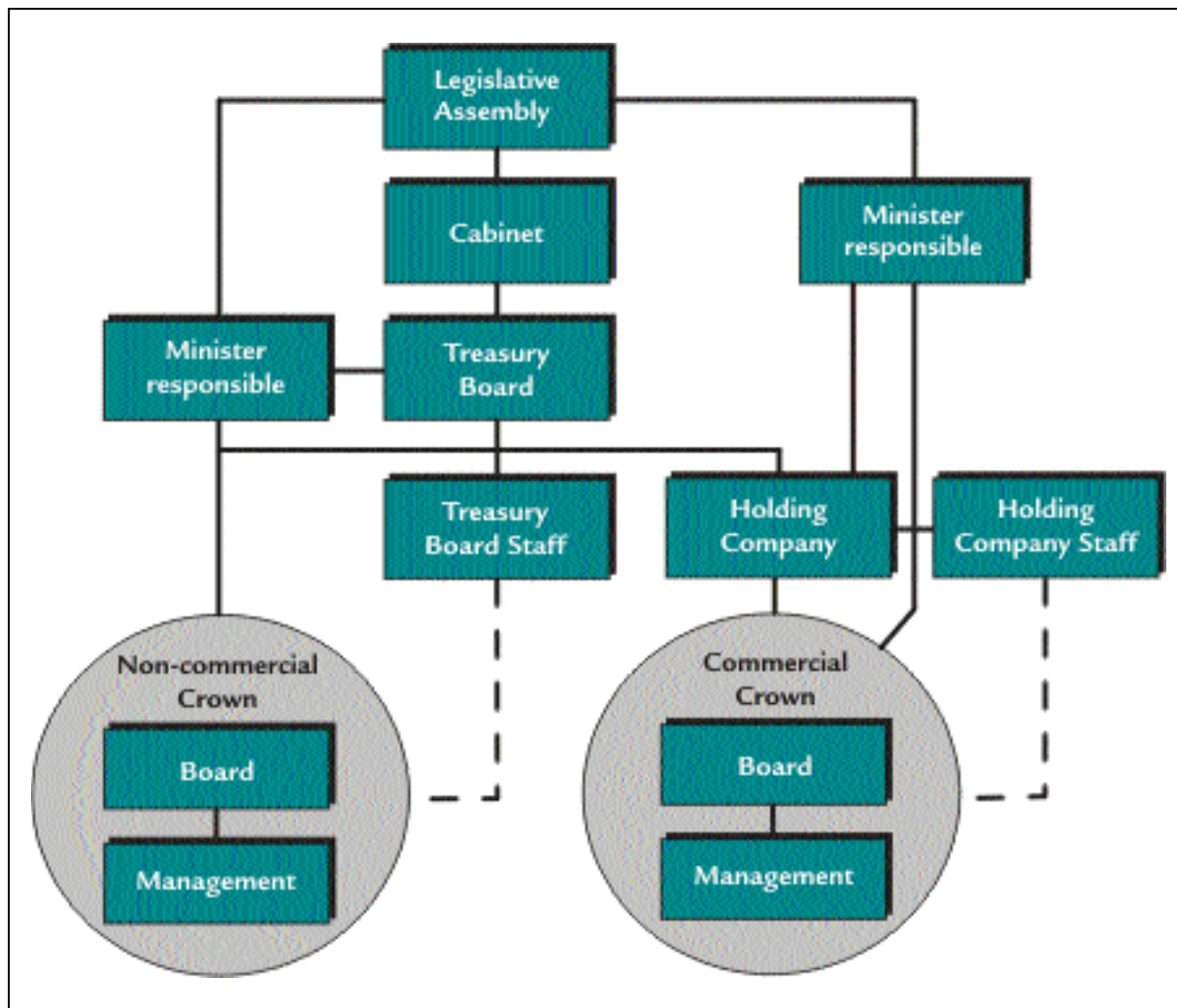
decision-making, participation on boards, specification of roles and responsibilities, and financial approval can be used to determine the degree to which there is autonomy for the corporation versus control by government.

### Practice in British Columbia

Shareholder rights and responsibilities in Crown corporations are shared between the Legislative Assembly and government (Exhibit 4). While many

### Exhibit 3

#### Saskatchewan Model of Crown Corporation Governance



of the people interviewed in this study stated that it is the people of British Columbia who own Crown corporations, in practice the Legislative Assembly and the government exercise rights on behalf of the people.

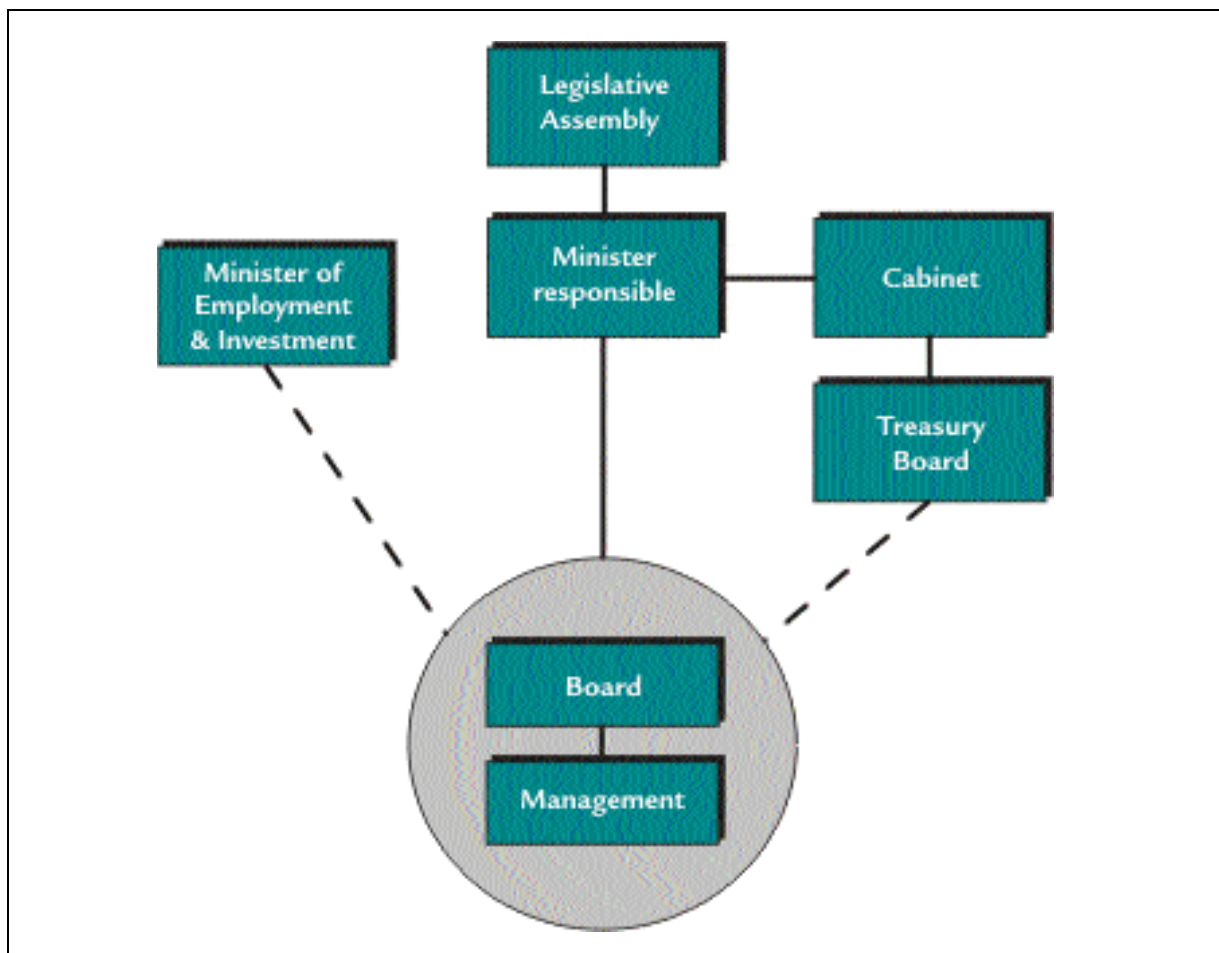
Government fulfills its responsibilities relating to Crown corporations through several parties. The primary authority rests with Cabinet, representing government as a whole. A Minister responsible for the corporation acts as the communications link between the Crown corporation and Cabinet,

and as the reporting link to the Legislative Assembly. As well, the Minister of Finance and Corporate Relations, who is also the Chair of Treasury Board, carries a significant role in the approval of capital and operating budgets of some corporations, and the Minister of Employment and Investment is responsible for implementing an appropriate accountability framework for Crown corporations.

A Crown corporation board does not have sole responsibility or authority to direct and supervise the corporation's affairs. Legislation

Exhibit 4

Crown Corporation Governance Structure in British Columbia



may allocate decision-making among the board, Cabinet, Treasury Board, the Minister responsible, and the Minister of Finance and Corporate Relations. Even central agencies, such as the Crown Corporations Secretariat, can have a powerful voice in decision-making for the corporation. This complicates the authority and responsibility relationships of government and its agencies with a Crown corporation's board.

Across Canada, philosophies vary as to the degree to which government should control Crown corporations.

In the following sections of the report we address governance issues at two levels: corporate governance—which deals with the broad issues under the control of government and external to a Crown corporation's board; and board governance issues that are directly under the control of a Crown corporation's board.



## corporate governance issues

There are a number of governance issues that are primarily external to a Crown corporation's board, but that have a significant impact on a board's ability to fulfill its governance role. These are issues that relate to the roles and relationships established between the shareholder representatives (Legislative Assembly and government, representing the shareholder, the general public) and the boards. In this part of the report we look at the following issues:

- clarity of roles;
- establishment, categorization, and dissolution of Crown corporations;
- appointment of boards;
- direction from government; and
- oversight of Crown corporations.

### Clarity of Roles

At the federal level, the *Financial Administration Act*, Part X, deals with governance and accountability matters for Crown corporations. That legislation documents the roles and responsibilities of those involved in governance (Appendix B), and is the most comprehensive legislation we examined in this regard.

In British Columbia no general legislation covers Crown corporation governance issues completely. Two acts, the *Financial Administration Act* and the *Financial Information Act*, contain provisions affecting Crown corporations but are limited in the issues addressed. The absence of general legislation means there is no one source for defining the roles

and responsibilities of those involved in the governance of Crown corporations in the Province. The majority of Crown corporations, and all of those established recently, have been established through their own enabling legislation. We examined the acts of our sample corporations to see if roles and responsibilities were clearly and consistently defined. We found a great deal of variability in the roles of those involved in governance of the corporations in the appointment process of the chair, the chief executive officer, and auditors, as well as in the requirements for tabling annual reports, holding annual meetings, and having Ministers sit on the board.

We noted the same inconsistencies in new Acts as well. For example, directors appoint the auditor under the *Community Financial Services Act (CFSA)*, but Cabinet appoints the auditor for Forest Renewal BC. For CFSA, the accounting system has to be satisfactory to the Comptroller General, but for two other Crown corporations, it has to be acceptable to the Minister of Finance.

Even where legislation does address roles at a general level, the limits of authorities and responsibilities must be specified further. This is particularly important in an environment where the Minister responsible can change frequently. Whenever there is a major change in appointment, it is important that all parties (Minister, chair, board, chief executive officer, and Crown Corporations Secretariat) establish what the relationships should be.



We believe that resolving the uncertainties and ambiguities in roles would be a major step forward in improving the governance environment in Crown corporations.

## Establishment, Categorization, and Dissolution of Crown Corporations

Ideally, the authorities required to establish or dissolve Crown corporations should be stated clearly so that government and the Legislative Assembly can fulfill their roles based on a pre-determined allocation of responsibilities. As well, the process and criteria by which Crown corporations are categorized should be clear to ensure that government and the Legislative Assembly obtain the degree of control they want over the corporations. There should also be a clear basis on which the continuing need for a Crown corporation is assessed and its potential dissolution is carried out.

### Establishing Crown Corporations

In looking at practices in other jurisdictions, we found that the authority for establishing and dissolving Crown corporations varies markedly. At the federal level, Part X of the *Financial Administration Act* states that incorporation and dissolution of parent Crown corporations requires an Act of Parliament. Subsidiaries can be established by an Order-in-Council. Information about the formation of subsidiaries must be tabled in Parliament.

Provincial situations are different. In a 1992 survey of

Canadian jurisdictions by the Canadian Council of Public Accounts Committees, eight provinces reported they had no legislated requirement to advise the Legislature when a Crown corporation was set up or disposed of by government.

Alberta's *Financial Administration Act* allows Crown corporations to be incorporated or dissolved, and subsidiaries acquired, with approval of the Lieutenant Governor in Council (LGC).

Saskatchewan's *Crown Corporations Act* also gives the LGC the authority to create Crown corporations. The LGC can designate new Crown corporations, as well as existing ones, as subsidiaries of the Crown Investments Corporation (CIC). Crown corporations that are not subsidiaries of CIC are called Treasury Board Crowns. These corporations are subject to Treasury Board's orders and directives. The Act requires the Minister to inform the Legislature of new Crown corporations by tabling a report setting out the name of the Crown, its objects and purpose, and the location of its head office.

Manitoba's *Financial Administration Act* states that the LGC may authorize a Minister to incorporate a Crown corporation, but it makes no reference to the role of the Legislative Assembly in this process.

In Ontario and Quebec, Crown corporations are established under their own enabling legislation.

In British Columbia no specific legislation identifies authorities for establishing or dissolving Crown corporations. All but one of the Crown corporations we reviewed were established under their own

legislation, and several new Crown corporations have been as well. This approach gives the Legislative Assembly a role in reviewing the appropriateness of the mandate, structures, authorities, and accountabilities contained in each Act of incorporation and makes the process public.

In British Columbia it is not clear what authorities are required to incorporate a subsidiary of a Crown corporation, and what information is to be provided to the Legislative Assembly about the subsidiary. We believe that clearer guidance is needed in this area to ensure that parent Crown corporations can demonstrate to the government that they have carried out due diligence in their needs assessments and can support the need for a subsidiary company on operational and financial grounds. As well, we believe that the Legislative Assembly should identify what information it needs regarding the establishment of subsidiaries.

## Categorizing Crown Corporations

Crown corporations can be established for many reasons. They may be entirely self-sufficient, as is the British Columbia Railway Company, or they may require substantial funding from government, as does British Columbia Transit. They may provide services primarily to the public, as does the British Columbia Ferry Corporation, or they may be focused inwardly on government, as is the British Columbia Buildings Corporation. Given these differences in purpose, not all Crown corporations may require the same level of oversight by

government and its agencies. Thus the degree of oversight and accountability expectations of the government and the Legislative Assembly could be based on some method of categorization of the corporations.

At the federal level, the *Financial Administration Act* divides the Crown corporations into two groups:

- those that depend on parliamentary appropriations or that operate in a non-competitive environment; and
- those that operate in a competitive environment and do not ordinarily depend on appropriations for operating purposes.

Ontario classifies its agencies, boards and commissions by their functions and schedules for administrative and financial control purposes. Three functions for these bodies have been defined: advisory, operational, and regulatory. Schedules recognize the degree of involvement with and reliance on government, how the agency is funded, and the overall nature of the agency mandate. Agencies, boards, and commissions are currently classified according to Schedules I (advisory and regulatory agencies), II (commercially oriented agencies), III (social or cultural agencies), IV (self-funding corporations), and non-scheduled (not fitting into schedules I to IV).

A recent review in Ontario suggested a new classification system be adopted based mainly on funding sources and the degree to which government staffing and operating policies must be adhered to.

We noted that in Saskatchewan there are two types of Crown corporations: Crown Investments Corporation Crown corporations and Treasury Board Crown corporations. A 1992 Report of the Saskatchewan Financial Management Review Commission recommended that legislation be introduced which categorizes government-owned entities and which specifies, for each category, the reporting requirements and financial control mechanisms which will be in place to ensure they are accountable to the Legislature. The recommended legislation has not yet been introduced.

British Columbia describes its Crown corporations as commercial, economic development, and social and government services. It also refers to them as being either funded or non-funded. Work is currently underway to establish the appropriate oversight provisions for these groups.

## Dissolving of Crown Corporations

Different jurisdictions have developed different systems for periodically assessing the continuing need for a Crown corporation.

At the federal level the requirement exists for an independent special examination to be conducted on parent and subsidiary Crown corporations at least once every five years. This gives government an opportunity to assess the effectiveness of the corporation and to examine whether the need for the body still exists.

In Ontario advisory and operational agencies not preparing

annual corporate plans, must, at least once every five years, be subject to a sunset review indicating whether any mandate or structural revisions, termination, amalgamation with another organization or privatization should be considered.

In Saskatchewan the Financial Management Review Commission recommended that the Legislative Assembly committee overseeing Crown corporations include in its process the review of corporation mandate statements.

In British Columbia, reviews have been carried out in the past to: reassess the purpose of Crown corporations upon the advent of a new government; examine special purposes such as privatization; and assess the performance of a particular Crown corporation. Since 1992, the Crown Corporation Secretariat has been reviewing mandates of Crown corporations as part of its activities.

The dissolution of Crown corporations in British Columbia also typically takes place with little debate in the Legislature. Operations may be terminated by government before legislation has been introduced to dissolve the corporation. A sunset clause has been adopted in some enabling legislation, providing for the legislation to be repealed at some future date unless the Legislative Assembly deems otherwise. Where no sunset clause has been incorporated, the legislation continues until the Legislative Assembly dissolves the corporation. None of the British Columbia Crown corporation legislation we examined had a sunset provision.

We found strong support for the requirement to have a thorough review to take place before a corporation is sold or dissolved. Support for all reviews being made public was also expressed. Such a process is being followed in Great Britain, where reviews of government's free-standing agencies occur at three- or five-year intervals. Key stakeholders have an opportunity to provide input into the process and the results of the reviews are made public.

## Appointment of Board Members

Governance is enhanced when boards can demonstrate that they have the mix of skills and experience necessary to carry out their responsibilities effectively.

We believe the starting point for an effective board is an appointment process that can demonstrate that government has:

- identified the skills, experience, and other attributes required of board members;
- sought expressions of interest for those positions;
- evaluated applicants or nominees against objective criteria; and
- selected from the applicants the person most likely to be an effective member of the board.

## Current Trends

The board appointment process has been undergoing change recently in both the private and public sectors. In the private sector, boards, through the chairs, are taking a more active role than in the past and are involved in developing profiles of board needs. As well, chief executive officers (CEOs) are

being consulted on director criteria and potential nominees. It is widely recognized that the board's composition should consider the present and future needs of the company and that the assessment of board needs should become an annual exercise rather than responding to vacancies as they arise.

In the public sector, similar changes are underway. At the federal level, the 1994 Veilleux Report recommended more objectivity and transparency in the appointment process. The main recommendation centered on the creation of "job profiles." The report recommended that chairs and CEOs coordinate the development of job profiles outlining key attributes in terms of experience and qualifications sought from potential candidates for the board. This process recognizes that the required mix of expertise on a board may change from time to time to suit changes in the operating environment.

At a 1994 conference of federal Crown corporations these recommendations were well supported. Since then a federal government representative has confirmed that the government wants to ensure that candidates with appropriate qualifications are appointed, and the Director of Appointments, Office of the Prime Minister, has announced that improvements are underway. These include:

- developing profiles for board needs with input from the CEO and chair;
- publishing job profiles describing the responsibilities and selection criteria used in appointments; and

- announcing vacancies in the Canada Gazette.

We also noted that the federal Auditor General, in a recent report, recommended that the primary criterion for selection of candidates be proven relevant expertise.

Also at the federal level, parliamentarians have a role in appointments. They can call appointees before a committee of the House to review their qualifications. A Standing Order of the House of Commons provides for the Minister responsible to table a copy of the Order in Council of a director's appointment within five sitting days of its appearance in the Canada Gazette. The appropriate committee of the House may consider the appointment within 30 days.

In Ontario there is an all-party Standing Committee on Government Agencies that can interview candidates for board positions, but it does not have a veto power. Our discussions with central agency staff in Ontario suggest that this process has resulted in a much better likelihood of good candidates being chosen.

In Alberta a new government policy requires Ministers to establish panels to review candidates for board positions and short-list suitable individuals for consideration by the Minister or Cabinet. The policy applies to more than 90 government agencies, boards, and commissions in the province. The Alberta Auditor General also recently recommended that the primary criterion for selection of candidates should be proven relevant expertise.

## Current Appointment Process in British Columbia

### *Roles in the Appointment Process*

In April 1992, the British Columbia government set up an Appointment Office for Agencies, Boards, and Commissions. Its mandate is to ensure that:

- Ministers have an opportunity to choose the best qualified people;
- the appointees represent the communities they serve; and
- there is a balance of interests on each board.

The office tries to ensure that a resume is on file for each potential candidate and when vacancies arise, provides a candidate list to the Minister. As well, the office is attempting to develop a directory of all agencies, boards, and commissions, which will be available to the public parties interested in serving on specific boards. This follows Ontario's example of publishing a directory annually that provides information on boards. We found in our study that awareness of the operations of the Appointment Office was limited.

Enabling legislation for Crown corporations makes it clear that it is Cabinet's role to appoint all directors. The role of the Minister responsible for a corporation is not identified in legislation. In practice the Minister responsible recommends candidates for Cabinet approval.

Enabling legislation in British Columbia also does not specify a role for the board in the appointment process. Consequently, practice varies widely, although a majority of directors in our study felt the board should play a greater role in the appointment process.

Suggestions for improvements focused on three areas: the board should be consulted during the process; the board should identify the skills and interests needed on the board; and the board should suggest potential nominees. These views are consistent with the trends underway in the private sector.

The role of a chair providing input on board appointments to the political level is informal and varies with the relationship the chair has with the Minister. Some chairs have had no input into recent appointments. Others have provided some input to the Minister responsible about the type of candidates required, or a particular candidate they suggested be added to the board.

We believe that the chair and board are in a good position to understand the needs of the board at any point in time and therefore should have a role in the appointment process. The federal approach of expecting the Minister responsible to consult with the board is a reasonable one.

In British Columbia the Legislative Assembly does not get involved in the appointment process. The results of our study support the Legislative Assembly having some type of review role. We believe that by involving the Legislative Assembly in the appointment process, the accountability that boards have to the Assembly as a shareholder representative could be reinforced.

### *Selection Criteria*

The importance of having appropriate selection criteria is fundamental to promoting the establishment of an effective board. We found that there was general

understanding of the government's desire to see gender equity and minority and regional representation on boards. There was also a recognition of the need to consider the overall strengths and weaknesses that exist on the board and the mandate and strategic direction the organization intends to take, as well as the development of job profiles as the basis for assessing the suitability of candidates.

We asked directors to identify the attributes they believe a board should possess. The attributes ranked as very important by more than half of our survey respondents were that of having general business knowledge, professional expertise such as legal or financial skills, and that of having prior experience on a corporation board, preferably in the private sector. We found that while most directors have had some prior board experience, only a small part was in the private sector. Most directors held the view that their own boards have a good mix of knowledge, experience, and demographic representation.

We encourage continued efforts by the government to ensuring that the needs of boards are understood, and to establishing an objective process for matching the best available candidates to those needs.

## Related Appointment Issues

### *Board Turnover*

It is the right of governments to look at existing boards and make changes. While this right is recognized and accepted, excessive turnover can have detrimental effects on a corporation's condition.

In the federal system, legislation limits board turnover to 50% of the board in any one year. In British Columbia no such guideline exists. We found that most boards had been replaced entirely or almost entirely at one time or another. In some cases, changeover occurred at times when continuity was needed to maintain due diligence.

It is the general opinion of our interviewees that this practice should not continue, as it is disruptive to the corporation and increases the time the new board needs before it can become a useful group. A more gradual approach to board turnover is suggested so that continuity in budget development, strategic planning, and dealing with key initiatives can be maintained.

#### *Size of Boards*

Having boards of the right size is critical to the value of the governance process. If boards are too large, decision-making may suffer and individual directors may question their contribution to the board. With too many members, debate on issues can become difficult. On the other hand a certain number are needed to have the mix of skills required. If boards are too small they may not have the resources necessary to discharge all of their responsibilities consistently and effectively.

One of the Toronto Stock Exchange governance report guidelines calls for each board to review its size and to reduce numbers to the point where decision-making is facilitated. Some governance authorities call for very small boards. One such authority sees ideal boards as being relatively small, generally from five to nine competent, active and responsible members.

Changes related to board size have occurred recently at the federal level. The Veilleux report (March 1994) recommended that there be a review of the size of boards of Crown corporations. Subsequently, the Auditor General reported in October 1995 that board membership in federal Crown corporations had been reduced from 530 in 1993 to approximately 400.

Overall, the majority of board members we interviewed felt that some of the current boards could be reduced and still operate effectively. We believe that a concerted effort to define an appropriate size could result in more effective boards with lower costs. Periodic consultations between the chair and Minister responsible would help ensure that changing circumstances are reflected in board requirements.

#### *Compensation of Directors*

Like other jurisdictions, British Columbia provides compensation and reimbursement of travel expenses for directors of Crown corporations. Guidelines on maximum compensation has been set by Cabinet. These provide for an annual fee of \$4,000 plus a per diem rate of \$500 for chairs, and an annual fee of \$3,000 and a per diem rate of \$300 for directors. Any remuneration up to the maximum amounts are set at the discretion of the individual Crown corporation. Remuneration above the maximum amounts requires prior Cabinet approval.

Board chairs generally felt that the current compensation levels are not always sufficient to attract candidates with the necessary qualifications to serve as directors and they were of the opinion that the rates should be reviewed.

## Direction from Government

The broad public goals of Crown corporations, as specified in legislation, are in place until and unless the Act that created them is revised. However, government objectives and priorities, on the other hand, are constantly evolving in order to keep up with changing situations. The Crown corporations we reviewed recognized the prerogative of government to provide them with specific direction, and to establish broad public policies to which all the Crown corporations adhere (such as fair wages and employment equity). What Crown corporations saw as an ideal process is one in which the government regularly and clearly communicates direction to its Crown corporations. Most Crown corporations wanted to receive government input to their planning process, to have their corporate plan approved in a timely manner, to then be left to operate with relatively little interference, and to be held to account for their performance against their corporate plans.

In British Columbia the strategic planning process is a key mechanism for direction setting. The Minister responsible for a corporation also plays an important role in communicating government's expectations. This section of the report looks at both of these ways in which government sets direction.

### Strategic Planning Initiatives

Until 1991, Crown corporations in British Columbia operated quite autonomously. There was no requirement for planning, and no one central agency was responsible for Crown corporations.

Since then significant changes have been made. *Financial Information Act* amendments now require a Crown corporation to provide the Minister responsible, the Minister of Finance and Corporate Relations, Cabinet, and any Cabinet committee with all strategic plans, business plans, capital and operating budgets, and any other information requested by the Minister responsible for the corporation.

Over the past few years, government has concentrated on developing a strategic planning process within the Crown corporation sector to ensure that Crown corporations develop strategic plans that incorporate government's direction. The Crown Corporations Secretariat (CCS), established in 1992, has developed guidelines for the preparation of strategic plans and has been involved in monitoring the progress of corporate plans. CCS guidelines note that: "these guidelines... create a mechanism for commercial Crown corporations to receive clearer and more explicit directions from the government." Accordingly, the strategic planning process provides the opportunity for government and Crown corporations to come to an agreement on the corporation's mandate and its public policy objectives.

### Clarifying Mandates

Legislative mandates must be broad enough that they do not need to be amended frequently and can accommodate changes in government priorities. As a result, Crown corporations are usually left to interpret their mandate from the broad legislation. It is therefore the board's responsibility to articulate a clear statement of purpose for the



Crown corporation, showing how it has interpreted the broad public policy goals it was designed to serve. Government's role is to ensure that it and the corporation agree on this interpretation.

In a 1995 report, the federal Auditor General noted that, where a mandate is unclear or a number of possible interpretations could be given to it, government is responsible for providing clear direction to the board.

The strategic planning process instituted by the Crown Corporations Secretariat provides government with a good opportunity to review a Crown corporation's mandate.

### Crown Corporation Objectives

In private sector for-profit corporations, the main objective is clear: to create wealth for the shareholder. For most Crown corporations, however, the objectives are often less clear and typically more multi-dimensional. A Crown corporation is expected to fulfill its legislated mandate or purpose while at the same time meeting various government public policy objectives. These objectives may focus on the well-being of the population or on some economic measure related to development opportunities and regional initiatives. If these objectives are not congruent with the legislated mandate, they need to be reconciled with Crown corporation strategies. This makes the setting of a clear direction, and through it the provision of effective governance, a challenge for Crown corporations.

The need to integrate public policy objectives into their operations makes the system of governance more difficult for

Crown corporations than for private sector companies. Both the directors and the chief executive officers of the Crown corporations in our sample described the tension produced in trying to meet public policy goals without jeopardizing the operational performance of the corporation.

Boards expressed concern that the pursuit of public policy objectives does not always coincide with the best interests of the business mandate of their corporations. Some said that legislation does not make clear that they are to pursue their commercial objectives only to the extent possible within constraints imposed by the public policy framework. To boards of commercial Crown corporations, this concept seems to contradict their commercial identity. When significant disagreement occurs, the board lets the government know by board resolution.

At the federal level the provision of public policy direction to Crown corporations has been formalized through the use of Cabinet directives. These directives convey the government's expectations and decisions to the board where the direction may be contrary to the board's business mandate. Use of these directives clarifies accountability for the decision. Directives are issued after the Minister responsible for the corporation has consulted with the board. They are then tabled with Parliament for scrutiny and debate.

In British Columbia the process for providing direction to a Crown corporation has not been formalized. A major review carried out by consultants in 1991 noted that there was no clear guidance on the issuance of directives, nor was

there a clear statement that Crown corporations had to abide by them. Of the legislation we reviewed, only that for British Columbia Hydro and Power Authority had a reference to directives.

### Role of the Minister Responsible for the Corporation

Board members generally look to the Minister responsible as the key player in establishing or conveying government direction for a Crown corporation. The results of our study indicate that directors think government's direction could be improved.

Crown Corporations Secretariat planning guidelines identify the role of the Minister responsible as: ensuring directions are communicated; advising the board about government plans; and making recommendations to Cabinet. The Order in Council appointing the Minister states that the Minister is "to administer the Act," but enabling legislation does not clearly describe what this means.

#### *Consulting with Boards*

We noted that boards wish to be consulted prior to receiving a ministerial direction. This would allow them to bring potential difficulties with the direction to the Minister's attention and to have any the necessary changes made so that the corporation could continue to operate within its legal framework.

#### *Conveying Consistent Messages to the Boards*

With changes in Ministers and in policy direction, getting consistent

messages can be a challenge. Interviewees of one Crown corporation related the experience of the corporation being moved among three ministries and six Ministers over the course of a four-year period. We were told that adherence to a corporate planning process would help achieve a level of consistency. Much of the direction Crown corporations receive currently is at times ad hoc and reactive, and most often occurs informally through contact between the Minister responsible and the Crown corporation chair.

#### *Providing Direction to the Boards*

Boards like to receive government direction from their Ministers, yet regular meetings—even an annual meeting—are often difficult to secure. Because of this difficulty, boards use other sources as a means of understanding the government's policy framework for their Crown corporations, such as having a government member on the board, having the Minister's assistant or Deputy Minister attend board meetings, or having the CEO relay information from central agencies such as the Crown Corporations Secretariat. The problem with this process is that messages may vary and it is then left to the board to interpret the government's policy direction. One way of reconciling policy direction is to align Crown corporations structurally with ministries that operate in the same sector.

Crown corporation representatives expressed a preference for a more formal process by which Ministers responsible would communicate their direction.

### *Meetings with the Board*

The degree to which Ministers interact with boards for which they are responsible varies greatly, creating additional communications problems in some instances. There are no clearly specified formal requirements and different Ministers can react to the same corporation in different ways, depending on their style, the corporation involved, and related corporate issues. In one case we were advised that the Minister had attended two meetings, while one of his predecessors had attended 16 or 17 in approximately the same period.

The chair is the formal link between the Minister and the board. Normally the chair and the CEO establish a system of communicating with the Minister and his or her staff. We found that practice varies as to whether the CEO or the chair is the actual point of contact for the Minister. There is no formal documentation of expectations between chair and Minister in British Columbia.

A more formal practice exists in Ontario. Crown corporations and other operational agencies with their own administrative support systems must, at least once every five years, prepare a Memorandum of Understanding between the chair and the responsible Minister. It is to include information on: their respective roles; the agency's objectives, priorities, performance expectations, and reporting requirements; the auditing arrangements; and the accountability relationship.

Having a clear understanding of respective roles is particularly useful in an environment where Ministers can change with great frequency. Board members we

interviewed believe that meetings between the Minister and chair, preferably with the board members in attendance, should take place at least annually to reduce the disruptive impact such changes can have.

As well, only two of the 10 Crown corporations we looked at require a formal annual meeting with the shareholders. We believe that requiring such an annual meeting for all major Crown corporations would help in clarifying government's expectations of corporate direction and strategies.

## Oversight of Crown Corporations

As Crown corporations implement their strategic and business plans, it is reasonable to expect that government would establish an appropriate monitoring regime to understand how the corporations are progressing against plans and to become aware of critical issues as they arise. One would also expect government to identify its information needs and establish agency roles and responsibilities to ensure that information is collected and made available to it.

### Oversight by Government

As already noted, Crown corporations in British Columbia operated relatively autonomously until 1991. Since then there have been significant changes that allow government to better oversee the activities of its Crown corporations. There are requirements under the *Financial Information Act* for the corporations to provide strategic plans, business plans, capital and

operating budgets, and any other information requested by the Minister responsible. Under the recently proposed accountability framework, the government has further identified its reporting requirements of Crown corporations.

## Role of the Crown Corporations Secretariat

Crown Corporations Secretariat (CCS) is the main central agency for overseeing Crown corporations. Established in 1992 as a support group to the Cabinet committee on Crown corporations, it currently reports to the Minister of Employment and Investment but retains the same role as it had when it was first established. Interviewees generally felt that, since CCS fulfills a central role, it should report to Cabinet rather than to a Minister. All Ministers would then view CCS as supporting them rather than just one Minister. This would also reduce the need for Ministers to rely on their Deputy Ministers as a resource for information on Crown corporations.

Over the past few years CCS has concentrated on developing a strategic planning process within the Crown sector. It has developed guidelines for the preparation of strategic plans and has been involved in monitoring the progress of corporate plans. Under these newly developed accountability guidelines, each Crown corporation is expected to incorporate performance targets in its planning processes and to provide regular reports to government that will include current, or most recent, information about actual performance.

## Coordination of Central Agency Roles

Although CCS is the main agency involved with Crown corporations, other central agencies—Treasury Board, the Office of the Comptroller General, and Treasury Division—also have roles to play. They provide staff support to Cabinet, Cabinet committees, the Minister responsible, and the Minister of Finance and Corporate Relations. With this number of agencies involved in different aspects of a Crown corporation's operations, it is easy for roles to become duplicated. Coordination of central agency efforts becomes an issue.

The CCS Planning Guidelines outline the responsibilities of central agencies as follows:

- monitoring the preparation of plans and project reports;
- providing advice and elaboration on government direction to executive and management during plan preparation; and
- monitoring corporate performance against approved plans, investigating significant variances, and submitting reports.

A memorandum of understanding has also been developed by CCS and central agencies to clarify their respective roles and responsibilities with regard to Crown corporations, and to set out the functions of the two boards of Cabinet—the Planning Board and Treasury Board. According to most central agency representatives interviewed, this memorandum has helped but better coordination is still needed.

## Role of Deputy Ministers

Deputy Ministers have no legislated role concerning Crown corporations. The *Interpretation Act* allows Deputy Ministers to act on behalf of Ministers, but there is no clear direction provided to the Deputies about Crown corporations.

Not surprisingly, we found that the level of involvement of Deputy Ministers varies. Some of them are closely involved with their Minister's Crown corporations, others have little or no involvement. In part, the variation is related to the level of involvement of the Minister. It is generally believed that the addition of CCS to the oversight process has lessened the need for Deputy Ministers to be involved with Crown corporations.

## Oversight by the Legislative Assembly

### *Information Needs In Other Jurisdictions*

The federal government requires the preparation of corporate plans for government approval and the tabling of related summaries for Parliament, along with an annual report outlining achievements. This concept is based on the following principles:

- Parliament will be informed of the objectives of Crown corporations as approved by government; and
- Parliament will receive a systematic flow of timely, pertinent information on actual performance so it can judge how well Crown corporations have achieved their stated objectives for each planning period.

The federal *Financial Administration Act* also spells out

how government directives to Crown corporations should be tabled. This ensures Parliament receives information about government's public policies for various corporations and that government is held accountable for the initiative arising out of the directive rather than the board. As well, legislation also makes clear that boards are not accountable for any consequences arising from the implementation of the public policy directive.

In addition, the federal *Financial Administration Act* provides for another form of information to be provided to Parliament. A special examination (value-for-money review) of each parent Crown corporation and its wholly owned subsidiary is to be carried out at least once every five years, and more often if requested by the Lieutenant General in Council or the board. If the examiner feels there is information that should be brought to the attention of Parliament, he or she must prepare a report for inclusion in the corporation's annual report.

In Manitoba, certain Crown corporations have to prepare quarterly financial statements for the Minister to table, as well as annual reports.

In 1992 the Saskatchewan Financial Management Review Commission recommended the government require a document to be released to the Legislative Assembly on each significant transaction or commitment involving a Crown corporation. The document was to describe:

- specific business and public policy objectives;
- financial implications and risk analysis;

- management process used;
- legislative authority for the decision; and
- organization structure for ongoing government participation and process for informing the public about status and performance.

In 1994 the Saskatchewan Crown Investments Corporation reported that it had made further improvements in providing information. It and its subsidiaries provided expanded presentations to the Crown Corporations Committee of the Legislature during 1994. It also described which types of transactions were to be reported to the committee within 90 days of the transaction occurring.

#### *Legislative Oversight in British Columbia*

In British Columbia there is no legislated provision establishing an oversight role by the Legislative Assembly. Once a Crown corporation is operating, all that is required is the tabling of an annual report. The 1996 report of the Public Accounts Committee on *Enhancing Accountability for Performance in the British Columbia Public Sector* explores these issues. The committee recognizes that the interaction between legislative and governmental systems must work together more effectively if there is to be an improved accountability and governance regime. The report makes the following recommendations about information needs of the Legislative Assembly in its oversight of Crown corporations:

- that the government publicly provide, on a timely basis:
  - information about the short- and long-term plans and goals

of ministries and Crown corporations, including their respective programs and past performance, and

- information about the results achieved, allowing comparison between the actual and planned performance of government ministries and Crown corporations;

- that such select standing committees be provided for that are deemed appropriate to consider ministry and Crown corporation programs by sector; and
- that the short and long-term plans and annual reports, once tabled, stand referred to the committees above.

#### Role of a Legislative Assembly Committee

Over the past 20 years British Columbia has had a checkered experience with Legislative Assembly committees on Crown corporations. The 1977 *Crown Corporation Reporting Act* established a Legislative Assembly committee to review five specific corporations. The terms of reference allowed for calling directors and officers of these Crown corporations not less than once every three years to review performance based on their annual reports. Annual reports laid before the House stood referred to the committee. The committee had authority to appoint employees, legal counsel, accountants and other advisers. It also had the power to compel the attendance of witnesses and the production of records. The Act was repealed in 1985.

While the Legislative Assembly annually establishes a Finance, Crown Corporations, and

Government Services Committee, reports in the past several years have not been referred to it. As such, it has not been able to exercise any oversight of Crown corporations. In our Office's 1990 report on Accountability of Crown Corporations to the Legislative Assembly, the need for more structured, periodic reviews of individual Crown corporations was identified.

We continue to support the need for an operating Legislative Assembly committee to oversee Crown corporations. While there are currently some opportunities to debate Crown corporation issues during the Estimates process, it is generally not considered an appropriate forum. The debate tends to focus on specific issues rather than broader ones such as Crown corporation mandates, their public policy roles, their strategic direction, and their impact on provincial finances.

The government has recently announced the establishment of a Legislative Assembly Crown Corporations Committee. While this is different from the sectoral committee structure recommended by the Public Accounts Committee, the designation of this new committee provides an opportunity for the Legislative Assembly to be an active participant in the development of an improved governance regime for Crown corporations.

## Public Policy Costs: Transparency of Funding

There is a growing acceptance in other jurisdictions that the funding and costs of public policy objectives should be separate from those of commercial objectives. This

allows for clearer recognition of what objectives are actually being achieved and their related costs.

In 1984 the federal government introduced the concept of government directives as part of the amendment to the *Financial Administration Act*. It required that, if a Crown corporation was asked to achieve some public policy objective beyond its mandate, the government would have to make its request public and fund the cost of implementation.

In Saskatchewan, the Provincial Auditor has recommended a similar approach. In a 1993 report he noted that Crown Investments Corporation carries out the government's public policy objectives through its investments, commitments, and other corporations. He believed it was necessary for government to define its public policy objectives clearly and to present them to the Legislative Assembly for scrutiny. The cost of public policy expenditures are expected to be paid from the general tax base or by transferring monies raised from other government activities. The Provincial Auditor recommended that financial statements include information about public policy expenditures.

In New Zealand, when there is a conflict between financial and policy objectives of commercial Crown corporations, the government compensates the corporations. The government has introduced a policy whereby it assumes funding responsibility whenever it directs that services be provided on other than a commercial basis. It has emphasized the importance of keeping separate the objectives of public policy and commercial activities, and reporting

on them. The corporations are then held accountable for the achievement of their commercial targets, which they report to Parliament.

In Australia, the State of Victoria Auditor General noted in his review of the Public Transportation Commission that, in the past, for management or accountability purposes, no distinction was made between funding for commercial operations and funding for public policy obligations. He concluded that there had to be better recognition of public policy objectives and their level of attainment. In its 1993/94 budget the government announced a new policy of assuming funding responsibility where it directs that services be provided on other than a commercial basis. It also emphasized the importance of separate identification of related costs.

There are three issues arising out of these initiatives: the need to track costs of public policy initiatives; the negotiation of funding of these costs; and the need to disclose these costs. We considered all of these matters as part of our study.

## Tracking and Disclosing Costs

The provision of services to meet a public need incurs a cost to the corporation. Making public policy and its costs transparent allows the public to know what the objectives are, the costs associated with them, and any other options that should be considered. When this is not done, several problems can be created.

- There may be lack of full disclosure of objectives.

- Information about the cost of mandated services and the cost of public policy objectives may be inadequate.
- Stakeholders may receive inconsistent treatment. Some may be paying more than others for government public policy objectives.

A real concern was expressed that when the costs of implementing public policy are “hidden,” the true costs of the programs they support are not accurately reflected. This reduces the effectiveness of program-related decisions. As well, not linking costs to the purpose for which they were spent hampers the accountability of all parties.

British Columbia Ferry Corporation is an example of a Crown corporation that is affected by a number of public policy decisions beyond the control of the directors. Decisions on fares, routes, and capital spending are made by the Lieutenant General in Council. These decisions may incorporate social and economic policy objectives along with corporate business objectives. Segregating these is important if accountability is to be clearly exercised. The new accountability framework proposed for government provides an opportunity for clearly accounting for public policy objectives and costs.

With this in mind, we believe the Province should explore the concept of identifying the costs of carrying out public policy decisions separate from the costs of carrying out the corporation’s commercial mandate.



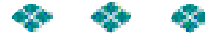
## Negotiating the Funding

Operating costs can be affected by adherence to broad government policies such as those related to wages and employment equity. These are seen as the cost of doing business as a public enterprise. Few corporations see a need for government reimbursement of these incremental costs. However, it is also felt that where Crown corporations are given specific directives to carry out a Crown-specific public policy direction, the source and allocation of funding should be negotiated.

When Crown corporations have public policy objectives that affect their financial performance, several financing strategies may be considered:

- cross subsidization in the rate structure;
- an appropriation from the government's Consolidated Revenue Fund; or
- contracted delivery of government programs where clients are direct beneficiaries of public policy.

A negotiated result may be the selection of one of these strategies or some combination of them. None of the board members in our study believe that their corporation has negotiated the cost of public policy initiatives with government.



## board governance issues

The board of a Crown corporation fulfills an important role in the governance process. It is responsible for setting the direction for the corporation and providing guidance and supervision to senior management of the corporation. To be able to carry out its duties effectively, it has to address the following significant issues:

- defining the board's role;
- orientation and education of directors;
- information for boards;
- relationship with the CEO; and
- evaluating board performance.

### Defining the Board's Role

#### Main Functions

Boards are responsible for the stewardship of their corporations. In the private sector, expectations for boards have changed since the 1980's. Directors' roles have increased as new duties have been assumed, such as examining the long-term strategies and management processes of the companies. Directors are also considered to have responsibilities not just to shareholders, but to employees, suppliers, customers, and the communities in which they do business. Legislation and regulations have broadened director responsibilities even further into issues such as human rights, hiring practices, and reporting and disclosure requirements.

To assist directors in fulfilling these new responsibilities, clearer guidelines and benchmarks are required to let them know what is expected of them. Development of

such guidelines has been underway for several years. For example the Toronto Stock Exchange governance report of 1994 contains 14 guidelines for improved corporate governance practices (Appendix C). The report states explicitly that boards should assume responsibility for stewardship of the corporation, including responsibility for: adopting a corporate strategy; appointing, training, and monitoring senior management; establishing a communication program among shareholders, other stakeholders, and the public; and ensuring the integrity of the corporate internal control and management information systems.

The United Kingdom's 1992 *Cadbury Report* identifies the responsibilities of the board as including the setting of the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business, and reporting to shareholders on their stewardship. It also provides a "Code of Best Practice" (Appendix E).

The federal guide, *Directors of Crown Corporations: An Introductory Guide to Their Roles and Responsibilities*, focuses on four primary responsibilities:

- establishing the corporation's strategic direction;
- safeguarding the corporation's resources;
- monitoring corporate performance; and
- reporting to the Crown.

According to the guide, boards should oversee the corporations on the Crown's behalf by holding

management accountable for the company's performance, its long-term viability, and the achievement of its objectives. This is similar to the role defined for private sector boards.

Our study showed that the majority of directors understand the main functions of the board's role as being to:

- set strategic direction and goals;
- evaluate the performance of the CEO;
- set significant policies;
- ensure the corporation has adequate resources;
- monitor and achievement of goals and objectives; and
- ensure that accountability obligations are discharged.

## Statutory Duties

In carrying out their roles, directors have three important statutory duties:

- a fiduciary duty (to act honestly and in good faith);
- a duty of care (exercise the care, diligence of a reasonably prudent person); and
- a conflict of interest duty (to disclose any direct or indirect interest in the affairs of the corporation).

For private sector companies in British Columbia, the *Company Act* has provisions related to these areas. Section 142 refers to duties of directors. It states that directors "shall act honestly and in good faith and in the best interests of the company" and "shall exercise the care, diligence and skill of a reasonably prudent person." Sections 144 and 147 identify directors' responsibilities in conflict

of interest situations. We found that the enabling legislation of the Crown corporation Acts we examined did not contain these requirements. None of the Acts we reviewed had sections on the directors' fiduciary duties, their duty of care, or conflict of interest provisions, although two Acts made reference to related sections in the *Company Act*.

The federal *Financial Administration Act* includes a section on directors' duties, which mirrors the *Company Act* as to fiduciary duties, duty of care, and conflict of interest. Manitoba and Saskatchewan contain similar references in their broad-based Crown corporation legislation.

## Understanding Interests Represented

Good governance requires that the board act as a whole. It is the board that makes decisions, not individual directors. When directors are not clear as to whose interests they represent, the potential for an ineffective board increases. This was made very clear in British Columbia recently. A 1995 government review of Workers' Compensation Board governance issues found that the bylaws identified the governors' primary duty and responsibility as being to represent the interests of their constituencies. The report authors stated this was wrong, that in fact the governors' primary responsibility was to the organization and all stakeholders.

The *Company Act* states the duties of directors is to "act honestly and in the best interests of the corporation." We found that none of the enabling legislation we reviewed contained this provision. Saskatchewan's legislation seems to

have captured the complexity related to Crown corporations. It states directors are to “act honestly and in good faith with a view to the best interests of the corporation while taking into account the public policy and business objectives of the Crown.”

Our study disclosed that most directors ranked the corporation first when identifying those interests they felt they were representing. The client and customer group, and the general public, were ranked second and third.

## Orientation and Education of Directors

Effective governance also requires a competent board—directors that understand the role of the board and their individual roles as directors. In the Crown corporation environment it is equally important that directors understand they are operating within a government environment that impacts on their roles and responsibilities. Providing a comprehensive orientation to new directors can enhance their understanding and ability to perform in the Crown corporation environment.

### Current Trends

Like many other governance initiatives, the expectation that directors will receive orientation and training is a recent trend. In a 1990 survey by the Institute of Directors in the United Kingdom, over 92% of respondents indicated they had no training or development for their directoral role. Such a result would be unlikely today. More recently there is increasing awareness of the need to provide orientation and training for directors.

The concept of orientation and training has been incorporated into the 1994 Toronto Stock Exchange governance report guidelines. Guideline No. 6 recommends that, as part of the appointment process, each new recruit be provided with an orientation and education program by the corporation.

There are similar expectations in the public sector. In Prince Edward Island, the Auditor General reviewed and reported in 1990 on the control and accountability arrangements for Crown corporations. Among the findings was the need to brief new directors on their individual responsibilities and on the operations of their specific corporations. In a 1995 update he reported that there was only a limited briefing process to ensure that all directors understand their responsibilities.

At the federal level, the Veilleux Report recommended that the Canadian Center for Management Development be mandated to provide training on such issues as the role of Crown corporations, accountability to Parliament, the public purpose served, role of boards versus the role of management, and other key areas of interest. The focus of training of new directors should be on having them appreciate the distinction that comes from serving on Crown boards. Unlike the private sector, directors of Crown corporations must balance the public policy objectives of the mandate with the more traditional obligation to serve the best interests of the corporation. The training package should also communicate the fundamental statutory and fiduciary responsibilities incumbent on any corporate director.

The federal Auditor General in 1995 urged boards of directors to improve orientation and education for recently arrived colleagues.

In the federal government's guide to the role and responsibilities of directors of Crown corporations, the need for orientation is supported. The guide notes that, as a first step, directors should become familiar with the general parameters of the legislation that created their corporation and any Acts applicable to it. Specific knowledge about the corporation—how it is organized and financed, and its services and products—can be picked up during board meetings. As to current practices, most federal Crown corporations provide briefing packages and tours of key locations, and sometimes set up consultations with knowledgeable individuals internal and external to the corporation.

## Director Orientation and Education in British Columbia

We found widespread agreement among Crown corporation directors that training would be useful. Some noted that this should be preceded by an agreement on roles and responsibilities of boards before effective training could take place.

At present there is no centralized training program developed for board members. The government is not involved productively in orienting new directors and no central group has a mandated responsibility to develop such a package. The Crown Corporations Secretariat has recognized the need but has not allocated any resources to this role.

We found that directors are generally getting orientation through various means. Most of the directors indicated that they had received an orientation that was useful but that could be improved upon. Areas they suggested for expansion include information about governance and a clearer discussion of their roles. Typically, board secretaries provide an introduction to board procedures, and senior management provides information about the corporation's business affairs. It is also common for new directors to get a tour of the corporation's facilities. At one Crown corporation, the initial orientation lasted an entire weekend. Six months later the directors attended another two-day session.

Most Crown corporations have developed directors' handbooks, that are considered to be useful orientation documents. One such handbook specifically identifies matters the board is responsible for approving and matters that Cabinet is responsible for approving. Another corporation has just developed a board governance manual and plans to include it in the orientation process.

We noted that the orientation provided to directors does not generally include a review of the relationship of the corporation to government and its agencies. Only a small number of directors felt that they had received sufficient information about this topic.

## Information for Boards

Information is the fuel that drives the governance process. To be effective, this information must meet the board's needs. The information characteristics can change depending on the use the

information is to be put to. Financial, operational, historical, and future-oriented information is of value for different purposes. The timeliness of the information and its quality and quantity are also factors that affect its value to a board. Lack of the proper information limits the board's ability to provide guidance to management. Boards have the right to expect that management will provide them with the information they need to fulfill their governance role. Boards also have the obligation to identify their information needs and ensure that management has implemented systems to capture that information.

### Current Trends

Much has been written recently about the need for private sector boards to become more active in monitoring management, and the need for boards to obtain the right information to enable them to perform their role of providing direction to management.

Information can be generated internally or a board may use external sources as information providers. The 1994 Toronto Stock Exchange governance report guideline No. 14 recommends that a board have a system that enables a director to engage an outside advisor.

The CCAF-FCVI Inc., a Canadian research and educational foundation, has developed a framework of six characteristics for improving the governance process (Appendix B). One of these calls for governing bodies to understand what constitutes reasonable information for good governance and obtain it. Exhibit 5 sets out the key elements of a system that can

provide effective governance information.

### Board Information in British Columbia

In British Columbia the need for a board to have the right information was recently highlighted by an investigation of conflict of interest issues at the B.C. Hydro and Power Authority. An interim report found that: "To carry out its responsibilities, a board requires important business information to enable it to judge the status of management performance and standards of conduct." The review team found there was scant information being provided to the board on the project it was examining. Many board members considered themselves inadequately briefed. This inhibited the board's ability to provide effective stewardship of the corporation regarding the joint venture the corporation entered into.

### Information from Management

We found widespread recognition of the need for boards to get the right information. Most directors felt that their board is being presented with sufficient, relevant information to make informed decisions. Similarly, most feel that the information allows the board to monitor performance against plans, that it is both historical and future-oriented in nature, and that it sufficiently describes the significant issues, changes, or problems affecting their Crown corporation. Directors are less confident, however, that they are receiving the appropriate level of detail.

In addition to the regular reports they are receiving, directors feel they have the opportunity to ask management for special reports and that they generally receive the information asked for.

### External Information Sources

We found that most boards are using external consultants and specialists for a wide range of information purposes, such as assisting with strategic planning initiatives and providing an independent judgment on management proposals.

The federal *Financial Administration Act* legislates a broad audit regime for Crown

corporations—an internal audit function, financial audits, and special examinations. This breadth assists boards in their requirement to exercise duty of care. Audits provide a source of information independent from management. One of the board’s responsibilities is to ensure that systems are in place to monitor the implementation of corporate initiatives. Audits can provide assurance to boards as to the adequacy of those systems for meeting their information needs.

In British Columbia there is no general legislation covering audit requirements for Crown corporations. Specific, enabling legislation refers only to annual financial audits. Most legislation

## Exhibit 5

### Key Elements of Effective Governance Information

| Conditions for Developing Effective Governance Information  | Attributes of Effective Governance Information   | Qualities of Effective Governance Information  |
|---|--|--|
| Knowledge of business<br>Leadership<br>Board/management agreement<br>Appropriate reporting principles<br>Stated levels of planned achievement<br>Fair use of information<br>Board capacity<br>Incentives<br>Organizational arrangements<br>Continuity<br>Regular assessment and review<br>Responsibility<br>Validation<br>Building on existing base | Management direction<br>Relevance<br>Appropriateness<br>Achievement of intended results<br>Acceptance<br>Secondary impacts<br>Costs and productivity<br>Responsiveness<br>Financial results<br>Working environment<br>Protection of assets<br>Monitoring and reporting | Explain options<br>Forward-looking<br>Illuminates policy and administration<br>Recognizes appropriate time frames<br>Facilitates comparisons<br>Promotes understanding without oversimplifying |

Source: Based on information provided by CCAF-FCVI Inc.

creating Crown corporations generally allows for audits directed by the Minister, Minister of Finance and Corporate Relations, or Treasury Board, but do not provide for statutory requirements beyond the financial statements. The provincial Auditor General can carry out performance audits of a Crown corporation's activities and report to the Legislative Assembly.

While there are no legislated requirements for audited information beyond financial audits for British Columbia Crown corporations, Treasury Board can direct the Office of the Comptroller General (OCG) to increase its involvement in internal audits of Crown corporations. OCG has already allocated some of its resources to work on Crown corporation issues—doing some audits under contract or assisting Crown corporation audit staff where needed.

We noted that boards have started to address the question of their information needs. When the recent accountability framework requirements are implemented, boards will have available a broader range of information.

## Relationship with the Chief Executive Officer

In the private sector, hiring and evaluating of the CEO are generally recognized as being among the most important responsibilities of board members. This also extends to the public sector. As one long-standing chair of a federal Crown noted, “The overriding priority of the board should be the appointment, development, support, and appraisal of the CEO. If that is done right, 65% of the board's job is done.”

## Current Trends

The importance of establishing a process for evaluating the CEO has been widely recognized. In the United States, the National Association of Corporate Directors' Commission, in its report of August 1994, recommended that all companies should institute a formal, continuing CEO evaluation. This review was to consider corporate financial results, as well as the CEO's performance measured against previously agreed criteria and objectives.

In Canada, the Toronto Stock Exchange governance report calls for boards, along with the CEO, to develop position descriptions for the board and the CEO, defining the limits to management's responsibilities. In addition, the board is expected to approve or develop the corporate objectives that the CEO is responsible for meeting.

At the federal level, the Auditor General recommended in 1995 that the board should provide to government periodic assessments of the performance of the CEO if it is to maintain the role of oversight of management.

## Board/CEO Relationships in British Columbia

### *Clarity of Board and CEO Responsibilities*

It is widely accepted that clarifying the respective roles of the board and the CEO has to be worked out if governance is to be effective. Not all Crown corporations have yet resolved this matter. It is important that respective responsibilities be clear and that the difference between governance and



management be recognized. Most of our interviewees recognized that intrusion into day-to-day management was not an appropriate activity for an effective board, and that there should be a clear delineation of board responsibilities and those of the CEO. We noted that directors' handbooks contain position descriptions and documented responsibilities. These are useful in clarifying relationships between boards and CEOs.

Many directors feel that they have clearly defined the respective authorities of the board and the CEO. Others, however, indicated that there is still clarification needed in some areas.

### *The CEO as a Board Member*

Most CEOs of the Crown corporations we surveyed are ex-officio members of the board (7 of 10). Those who are voting members of the board have strong views about this issue. They believe that being on the board is preferable and point out that such practice is common in the private sector.

There are also strong arguments for not having the CEO be a board member. Full segregation between the board role and the CEO role is viewed as fundamental to maintaining an appropriate accountability relationship—a clear line between board and management—without overlaps. It is felt that the CEO's job is not to set policy but to implement it.

### *Combined Chair and CEO Position*

While combined chair and CEO positions are found in the private sector, none of the Crown corporations we examined had such positions. One argument for keeping the roles separate is not to

risk losing both positions at once through a resignation or termination. Another argument, as noted above, is the need to maintain the integrity of the management system by separating the positions of chair and CEO.

### *Evaluating the CEO*

Most directors in our study feel that evaluating the performance of the CEO is a "very important" part of the board's role. Directors' handbooks recognize that one of the board's responsibilities is to carry out an evaluation of the CEO. In one Crown corporation, the directors' handbook calls for a semi-annual CEO review with the board involved in assessing performance and the chair discussing the results with the CEO. Another Crown corporation requires a review of the CEO's performance on an annual basis.

We found that some Crown corporations do not formally assess their CEO; however, most boards have an informal assessment process. Typically, it involves the board or a board committee reviewing performance against established criteria and having the chair review results with the CEO. An interesting suggestion made by one of our interviewees for improving the process was that the assessment process include an annual meeting with the Minister, at which the board reports on the CEO's performance.

### *Evaluating Board Performance*

Only recently has evaluation of board performance become one of importance to the governance process. Few assessments were done in the past because there was no expectation that they be done.

This has changed as performance expectations of boards have risen. Increased attention is also being given to assessing the performance of individual directors.

## Current Trends

The 1994 Toronto Stock Exchange report guideline No. 5 calls for boards to assess their effectiveness as a whole, as well as that of their committees and individual directors.

The August 1994 report of the National Association of Corporate Directors' Commission recommends that boards evaluate themselves on the effectiveness of their structure, procedures, and review processes. If performance is found lacking, boards should take steps to bring corporate governance policies to a higher standard. The report also recommends that boards evaluate individual director performance and replace those who are ineffective.

Private sector firms have developed evaluation forms that are being used for both board and director evaluations. These vary in their level of detail. We have reviewed examples that include a 12-page document and another of two pages in length.

A board member of several private-sector companies indicated to us that all of his boards are now expected to do a self-evaluation of the board as a whole. He expects his boards will move to a review of individual director performance within a year. Board governance committees are charged with the responsibility for doing individual director assessments.

At a recent conference of federal Crown corporations, there was agreement that there should be an assessment of board performance. One option suggested for doing this is through the chair working with outside consultants. However, it was noted that boards should not rush into this until a good evaluation process for the CEO and senior management is in place. It was also suggested that the components that make up board effectiveness be incorporated into an evaluation process for Crown corporation boards. These include:

- how the board is composed;
- the information that goes to the board;
- the committee structure; and
- the terms of reference for the CEO and the board.

## Board Evaluation in British Columbia

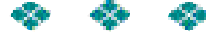
We found that an evaluation process has been started at some Crown corporations. One directors' handbook we examined calls for review of the board's performance. The board is to discuss its overall performance as part of a full board meeting annually in December. Forms have been developed for these reviews. Another handbook also calls for a self-assessment as part of reviewing performance.

Much of what is being done to evaluate board performance in other Crown corporations involves general discussions without yet having formal processes in place.

## Individual Director Performance

Evaluation of individual directors should follow from a board evaluation process. Since board assessment is still at an early stage, individual director assessment is not well developed. Some clear expectations are being set, however. For example, one directors' handbook calls for performance assessments to be done annually

through individual director discussions with the chair. A checklist has already been developed for these reviews for use by individual directors in assessing their own performance before having private meetings with the chair.



## accountability to the legislative assembly

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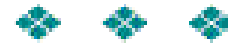
The federal *Financial Administration Act* makes clear that each Crown corporation is ultimately accountable to Parliament. British Columbia, as described throughout this report, has no such legislation to clarify a Crown corporation's accountability relationship. However, a Crown corporation's enabling legislation requires that the Minister responsible for the corporation receive its annual report and table it in the Legislature within the time specified in its Act.

A review of Crown corporation accountability by our Office in 1990 concluded that not enough annual report information was being provided on what Crown corporations had achieved. The government is now in the process of establishing a comprehensive accountability framework for its Crown corporations. Under the accountability framework proposed jointly by the Auditor General and the Deputy Ministers' Council for British Columbia, an implementation plan for Crown corporations to report to the Legislative Assembly includes a requirement for annual reports that focus on performance information. The new requirements apply to 1997 reports.

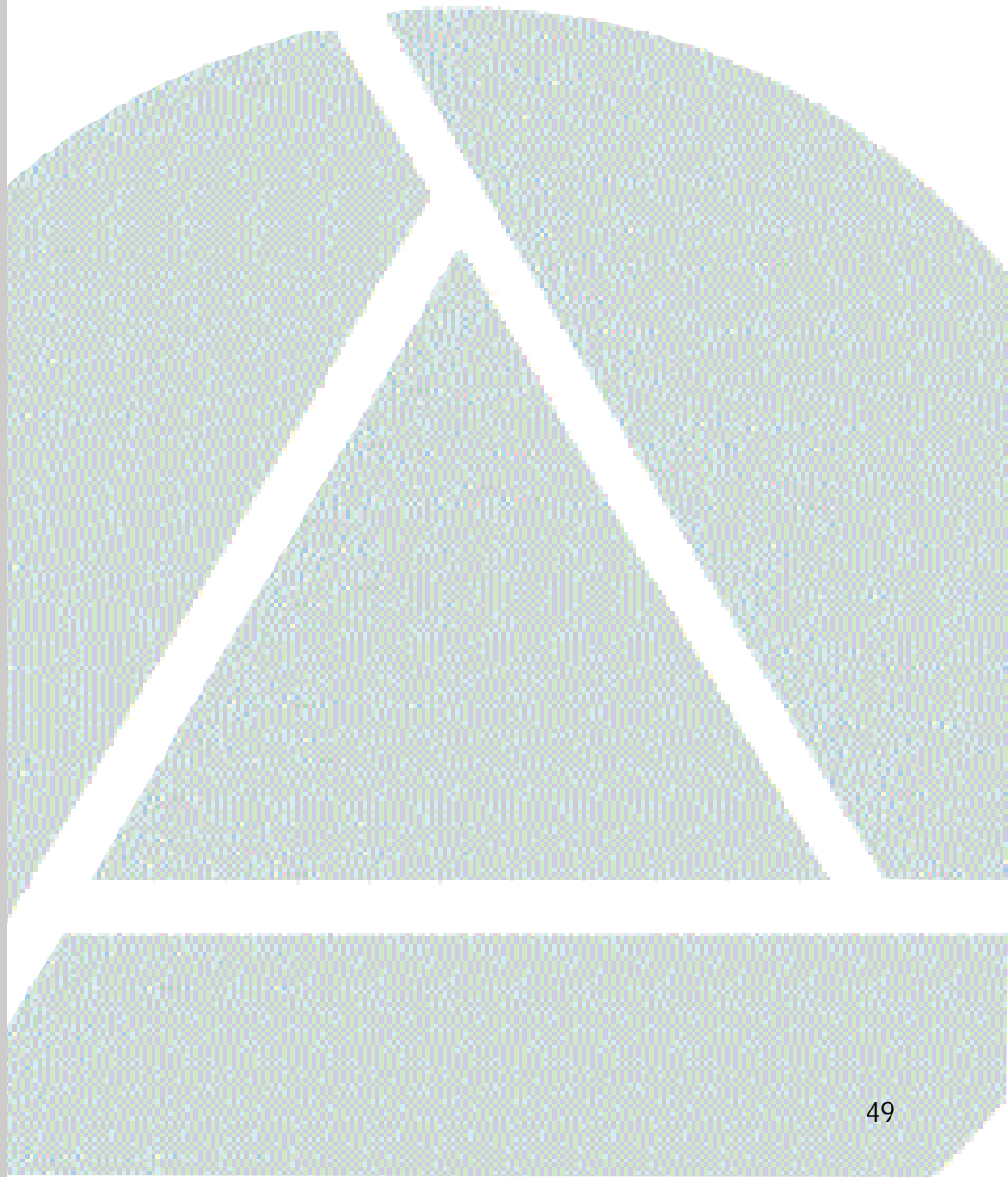
While the performance information needs have been identified, there are no accepted guidelines to address the overall contents of Crown corporation annual reports.

Several jurisdictions have taken the step of developing guidelines to ensure some minimum level of consistency in annual reports. In 1993 the federal Crown Corporations Directorate published a guide for the preparation of Crown corporation annual reports. This was done in recognition of legislated requirements and the four occasions since 1976 that the federal Auditor General had criticized the quality of Crown corporation reports. For the private sector, the Canadian Institute of Chartered Accountants issues guidelines as to information characteristics appropriate for the content of annual reports.

We found that directors generally do not feel that they have a good understanding of what information should be provided to be more accountable. Only a minority feel confident that the board has developed adequate guidelines to ensure it is providing sufficient information to meet the needs of its various stakeholders.



# appendices



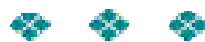
# appendix a

## The Federal Framework for Governance and Accountability of Crown Corporations

Part X of the *Financial Administration Act*, established in 1984, sets out a framework of roles and responsibilities for those parties involved in Crown corporation

governance. The federal Auditor General has reported that it is a sound legislative framework and has been working well for the 11 years that it has been in force. It allows corporations to act with an appropriate degree of independence while providing for appropriate accountability to government and Parliament.

| Roles & Responsibilities as Legislated by Part X of the <i>Financial Administration Act</i>                                       |                               |  |                              |   |  |  |
|---|-------------------------------|--|------------------------------|---|--|--|
|   | Parliament                    | Governor in Council                          | Treasury Board               | Minister Responsible  | Board of Directors                                     | Management                                   |
| <b>Creation, acquisition, disposal, dissolution</b><br>Parents<br>Subsidiaries  | approve                       | approve                                      | review<br>review             | recommend<br>recommend  |  |  |
| <b>Appointments</b><br>Directors<br>Chairs<br>CEOs<br>Senior management<br>Auditors of parent                                     |                               | approve<br>appoint<br>appoint<br><br>appoint |                              | appoint<br>recommend<br>recommend<br><br>recommend              | advise<br>advise<br>appoint<br>advise                  |  |
| <b>Setting Direction</b><br>Corporate plans<br>Operating budget<br>Capital budget<br>Summaries of plans and budgets<br>Directives | receive<br>receive            | approve<br><br>approve                       | review<br>approve<br>approve | recommend<br>recommend<br>recommend<br><br>approve<br>recommend | approve<br>approve<br>approve<br><br>approve<br>advise | prepare<br>prepare<br>prepare<br><br>prepare |
| <b>Oversight</b><br>Internal audit<br>Annual audit<br>Special examination   | receive<br>may receive        |  |                              | receive<br>may receive  | receive<br>receive<br>receive                          | receive<br>receive<br>receive                |
| <b>Accountability</b><br>Corp. Annual Report<br>Consolidated annual report<br>Annual report on tablings                           | receive<br>receive<br>receive |  | prepare<br><br>prepare       | receive   | approve  | prepare                                      |



## appendix b

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### CCAF-FCVI Inc. (A Canadian Research and Educational Foundation)

#### Characteristics of Effective Governance

- 1. Governing bodies are comprised of people with the necessary knowledge, ability, and commitment to fulfill their responsibilities.**

The focus is on the capacity of the group of directors collectively to have the characteristics necessary to allow them to meet their obligations. This principle contemplates that directors will see their obligations as extending beyond merely putting in the time required to having a real desire to set the course for the organization.

- 2. Governing bodies understand their purposes and whose interests they represent.**

The difference between managing and governing must be understood. This means that the boundary between senior management responsibilities and board responsibilities must be well established. One group steers, the other rows. The independence from management must be understood. Governing bodies must also understand whose interests they serve. This requires an understanding and balancing of government priorities and corporate priorities.

- 3. Governing bodies understand the objectives and the strategies of the organization they govern.**

Board members should be well versed in the basic objectives of the corporation and approve the strategies to be used to achieve those objectives.

- 4. Governing bodies understand what constitutes reasonable information for good governance and obtain it.**

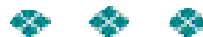
Information governing bodies need can have different attributes depending on the uses the information is to be put to. Quality, quantity and timeliness must be considered. The information may be backward-looking, highlighting expenditures made or performance levels achieved. It may be forward-looking, identifying performance measures and intended performance targets. The information may be provided by internal or external sources, which in turn, may affect the level of assurance governing bodies have about the completeness and reliability of the information. The characteristics and attributes of information needs has sufficient scope that governing bodies need to identify to management the different information needs they have and ensure that systems are developed to provide that information flow.

**5. *Once informed, governing bodies are prepared to act to ensure that the organization's objectives are met and that performance is satisfactory.***

Having the right people, understanding the strategies and objectives and getting information needs met does not necessarily lead to good governance. When presented with evidence of the need to act, governing bodies must have the courage and integrity to act on the information. Marginal decisions are not the issue here, but the willingness to act on the decisive matters facing the governing body. Governing bodies must have the capacity to act on the information given to them. Responsibility must be balanced by the authority and power needed to act.

**6. *Governing bodies fulfill their accountability obligations to those whose interests they represent by reporting on their organization's effectiveness.***

Someone gives authority for the governing body to act. An obligation exists for the governing body to account for its actions. This is the accountability relationship inherent in this principle is the expectation that the governing body may be accountable to more than one group and different levels of accountability may exist. Within Crown corporations, the shared decision-making may cloud some of the accountability relationships. These must be clearly understood if accountability is to be exercised by those with the authority to act.





## appendix c

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### Toronto Stock Exchange Committee on Corporate Governance in Canada

#### Guidelines and Recommendations for Corporate Governance (1994)

##### *Guidelines*

(1) The board of directors of every corporation should explicitly assume responsibility for the stewardship of the corporation and, as part of the overall stewardship responsibility, should assume responsibility for the following matters:

- (i) adoption of a strategic planning process;
- (ii) the identification of the principal risks of the corporation's business and ensuring the implementation of appropriate systems to manage these tasks;
- (iii) succession planning, including appointing, training and monitoring senior management;
- (iv) a communications policy for the corporation; and
- (v) the integrity of the corporation's internal control and management information systems.

(2) The board of directors of every corporation should be constituted with a majority of individuals who qualify as unrelated directors. An unrelated director is a director who

is independent of management and is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the corporation, other than interests and relationships arising from shareholding. A related director is a director who is not an unrelated director. If the corporation has a significant shareholder, in addition to a majority of unrelated directors, the board should include a number of directors who do not have interests in or relationships with either the corporation or the significant shareholder and which fairly reflects the investment in the corporation by shareholders other than the significant shareholder. A significant shareholder is a shareholder with the ability to exercise a majority of the votes for the election of the board of directors.

(3) The application of the definition of unrelated director to the circumstances of each individual director should be the responsibility of the board which will be required to disclose on an annual basis whether the board has a majority of unrelated directors or, in the case of a corporation with a significant shareholder, whether the board is constituted with the appropriate number of directors which are not related to either the corporation or the significant shareholder. Management directors are related directors. The board will also be required to disclose on an annual basis the analysis of the application of the principles supporting this conclusion.

(4) The board of directors of every corporation should appoint a committee of directors composed exclusively of outside, i.e. non-management directors, a majority of whom are unrelated directors, with the responsibility for proposing to the full board new nominees to the board and for assessing directors on an ongoing basis.

(5) Every board of directors should implement a process to be carried out by the nominating committee, or other appropriate committee, for assessing the effectiveness of the board as a whole, the committees of the board and the contribution of individual directors.

(6) Every corporation, as an integral element of the process for appointing new directors, should provide an orientation and education program for new recruits to the board.

(7) Every board of directors should examine its size and, with a view to determining the impact of the number upon effectiveness, undertake where appropriate, a program to reduce the number of directors to a number which facilitates more effective decision-making.

(8) The board of directors should review the adequacy and form of the compensation of directors and ensure the compensation realistically reflects the responsibilities and risk involved in being an effective director.

(9) Committees of the board of directors should generally be composed of outside directors, a majority of whom are unrelated directors, although some board committees, such as the executive committee, may include one or more inside directors. An inside

director is a director who is an officer or employee of the corporation or of any of its affiliates.

(10) Every board of directors should expressly assume responsibility for, or assign to a committee of directors the general responsibility for, developing the corporation's approach to governance issues. This committee would, amongst other things, be responsible for the corporation's response to these governance guidelines.

(11) The board of directors, together with the CEO, should develop position descriptions for the board and for the CEO, involving the definition of the limits to management's responsibilities. In addition, the board should approve or develop the corporate objectives which the CEO is responsible for meeting.

(12) Every board of directors should have in place appropriate structures and procedures to ensure that the board can function independently of management. An appropriate structure would be to (i) appoint a chair of the board who is not a member of management with responsibility to ensure the board discharges its responsibilities or, (ii) adopt alternate means such as assigning this responsibility to a committee of the board or to a director, sometimes referred to as the lead director. Appropriate procedures may involve the board meeting on a regular basis without management present or may involve expressly assigning the responsibility for administering the board's relationship to management to a committee of the board.

(13) The audit committee of every board of directors should be composed only of outside directors.

The roles and responsibilities of the audit committee should be specifically defined so as to provide appropriate guidance to audit committee members as to their duties. The audit committee should have direct communication channels with the internal and external auditors to discuss and review specific issues as appropriate. The audit committee duties should include oversight responsibility for management reporting on internal control. While it is management's responsibility to design and implement an effective system of internal control, it is the responsibility of the audit committee to ensure that management has done so.

(14) The board of directors should implement a system which enables an individual director to engage an outside advisor at the expense of the corporation in appropriate circumstances. The engagement of the outside advisor should be subject to the approval of an appropriate committee of the board.

#### *Recommendations for Legislative Reform*

The implementation of the above proposals is based upon the recommendation to The Toronto Stock Exchange that the Exchange adopt, as a listing requirement, the disclosure by each listed corporation incorporated in Canada or a province of Canada of its approach to corporate governance, on an annual basis commencing with companies with June 30, 1995 year ends. In addition, the following recommendations for legislative reform are made:

(1) That the governing corporate statutes be revised to eliminate any possible interpretation of the

directors' responsibility as being to manage the business day-to-day. Rather, the statutes should describe the responsibility as being to supervise the management of the business.

(2) The government departments responsible for the administration of the corporate laws in each of the federal and provincial jurisdictions should undertake a review of all legislation enacted in their particular jurisdiction imposing personal liability upon directors. Following the review, all legislatures should repeal or modify legislation imposing personal liability on directors which no longer serves the purpose for which it was enacted and legislation not so repealed should be amended if necessary, to ensure directors are provided with an effective due diligence defence.

(3) That the issue of legislated civil liability upon directors in respect of timely and continuous disclosure by corporations should be examined by Canada's securities administrators and any proposal should afford the business and financial community with an opportunity to comment. The Committee did not support any recommendations to legislate civil liability of directors for timely and continuous disclosure, unless the general recommendation concerning civil liability of directors is also accepted and implemented.



## appendix d

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### Canadian Institute of Chartered Accountants Pronouncements

The Canadian Institute of Chartered has issues two recent pronouncements dealing with matters of importance to good governance. The first, *Guidance on Control*, was issued in November 1995. This guidance is intended to be useful primarily to directors, managers and other people who are accountable in an organization. It is intended to help improve control. The guidance is provided by a control framework consisting of the definition of control, the criteria of control and the grouping of criteria.

Control is defined as those elements of an organization (including its resources, systems, processes, culture, structure and tasks) that, taken together, support people in the achievement of the organization's objectives. The framework includes 20 criteria for effective control, in four groupings.

#### Criteria of Control and Their Groupings

*Purpose – Providing a Sense of the Organization's Direction*

- A1 Objectives should be established and communicated.
- A2 The significant internal and external risks faced by an organization in the achievement of its objectives should be identified and assessed.

A3 Policies designed to support the achievement of an organization's objectives and the management of its risks should be established, communicated and practiced so that people understand what is expected of them and the scope of their freedom to act.

A4 Plans to guide efforts in achieving the organization's objective should be established and communicated.

A5 Objectives and related plans should include measurable performance targets and indicators.

*Commitment – Providing a Sense of the Organization's Values and Identity*

B1 Shared ethical values, including integrity, should be established, communicated and practiced throughout the organization.

B2 Human resource policies and practices should be consistent with an organization's ethical values and with the achievement of its objectives.

B3 Authority, responsibility and accountability should be clearly defined and consistent with an organization's objectives so that decisions and actions are taken by the appropriate people.

B4 An atmosphere of mutual trust should be fostered to support the flow of information between people and their effective performance toward achieving the organization's objectives.

*Capability – Providing a Sense of the Organization’s Competence*

- C1 People should have the necessary knowledge, skills, and tools to support the achievement of the organization’s objectives.
- C2 Communication processes should support the organization’s values and the achievement of its objectives.
- C3 Sufficient and relevant information should be identified and communicated in a timely manner to enable people to perform their assigned responsibilities.
- C4 The decisions and actions of different parts of the organization should be coordinated.
- C5 Control activities should be designed as an integral part of the organization, taking into consideration its objectives, the risks to their achievement and the inter-relatedness of control elements.

*Monitoring and Learning – Providing a Sense of the Organization’s Evolution*

- D1 External and internal environments should be monitored to obtain information that may signal a need to re-evaluate the organization’s objectives or control.
- D2 Performance should be monitored against the targets and indicators identified in the organization’s objectives and plans.
- D3 The assumptions behind an organization’s objectives should be periodically challenged.
- D4 Information needs and related information systems should be

reassessed as objectives change or as reporting deficiencies are identified.

- D5 Follow-up procedures should be established and performed to ensure appropriate change or action occurs.
- D6 Management should periodically assess the effectiveness of control in its organization and communicate the results to those to whom it is accountable.

*Guidance for Directors*

*– Governance Processes for Control*

The second pronouncement, *Guidance for Directors – Governance Processes for Control*, was issued in December 1995. This document is intended to provide guidance for a board of directors to fulfill its responsibility for control. The document contains many sample questions for each area of board responsibility that directors can ask themselves individually or that the board itself could consider. Guidance is provided in six areas of board responsibilities.

*Approving and Monitoring Mission, Vision and Strategy*

This section deals with the board’s role in endeavoring to see that the organization has the right approach to add to shareholder and/or stakeholder value, and to improve its chances of viability and success.

*Approving and Monitoring the Organization’s Ethical Values*

This section deals with the board’s role as guardian of the organization’s values, as its conscience.

*Monitoring Management Control*

This section deals with the board's overview of the systems whereby the chief executive officer and senior management exercise their power and influence over the rest of the organization.

*Evaluating Senior Management*

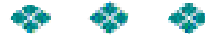
This section deals with the board's evaluation of the competence and integrity of the chief executive officer and other members of senior management, as it is primarily through them that the board exercises its power and influence.

*Overseeing External Communications*

This section deals with the board's responsibility with respect to the organization's communication of information to and from external parties.

*Assessing the Board's Effectiveness*

This section deals with how the board assesses how well it discharges its roles and responsibilities as part of the organization's overall control.



## appendix e

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### The Cadbury Report

The *Cadbury Report* on corporate governance was released in the United Kingdom in 1992. It was accepted by the London Stock Exchange as the basis for corporate governance for listed companies.

#### Code of Best Practice

##### *The Board of Directors*

- The board should meet regularly, retain full and effective control over the company and monitor the executive management.
- There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognized senior member.
- The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions.
- The board should have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the company is firmly in its hands.
- There should be an agreed process for directors in the furtherance of their duties to take independent professional advice if necessary, at the company's expense.

- All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that all board procedures are followed and that applicable rules and regulations are complied with. Any question of the removal of the company secretary should be a matter for the board as a whole.

##### *Non-Executive Directors*

- Non-executive directors should bring an independent judgment to bear on issues of strategy, performance, resources, including key appointments, and standards of conduct.
- The majority should be independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent judgment, apart from their fees and shareholding. Their fees should reflect the time which they commit to the company.
- Non-executive directors should be appointed for specified terms and reappointment should not be automatic.
- Non-executive directors should be selected through a formal process and both this process and their appointment should be a matter for the board as a whole.

##### *Executive Directors*

- Directors' service contracts should not exceed three years without shareholders' approval.

- There should be full and clear disclosure of directors' total emoluments and those of the chairperson and highest-paid UK director, including pension contributions and stock options. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained.
- Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors.
- The board should establish an audit committee of at least three non-executive directors with written terms of reference which deal clearly with its authority and duties.
- The directors should explain their responsibility for preparing the accounts next to a statement by the auditors about their reporting responsibilities.
- The directors should report on the effectiveness of the company's system of internal control.
- The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

### *Reporting and Controls*

- It is the board's duty to present a balanced and understandable assessment of the company's position.
- The board should ensure that an objective and professional relationship is maintained with the auditors.





