

14 NOVA SCOTIA INNOVATION CORPORATION

BACKGROUND

14.1 The Nova Scotia Innovation Corporation (InNOVAcorp) was established in 1994 by the Innovation Corporation Act. The objectives of the Corporation are noted in the Act, and include the following:

- "... to allow for technological development and commercialization in priority technology areas defined by the Corporation;
- become a strategic equity partner in joint-venture, private-sector technology initiatives; and
- provide incubator facilities to new technology enterprises and business support services to growing technology organizations..."

14.2 The creation of InNOVAcorp consolidated several technology organizations owned by the Province, including the Nova Scotia Research Foundation Corporation (NSRF). The Act also transferred the administration of and responsibility for the Nova Scotia First Fund (NSFF) to InNOVAcorp. At that time, the Fund was being administered by the Department of Finance.

14.3 The Innovation Corporation Act allowed for the dissolution of the Nova Scotia Research Foundation Corporation. This took place in 1996 and the net assets of NSRF were transferred to InNOVAcorp. Over time, the activities of InNOVAcorp have shifted from those previously associated with the NSRF, such as lab and environmental testing. InNOVAcorp is now focused on technology commercialization, with three activities as described below:

- **Investing** - designed to support promising entrepreneurs from start-up through to first-stage expansion.
- **Mentoring** - provided through direct support using InNOVAcorp staff and affiliations with organizations such as the National Research Council; through peer networking; and through InNOVAcorp's on-line service delivery tool.
- **Incubation** - provided through space and services to early-stage technology companies, especially those in the life sciences and information technology sectors. Incubation offers services, resources and guidance that many entrepreneurs do not have the skills, time, money or desire to handle or otherwise access on their own.

14.4 The head office of InNOVAcorp is located in Dartmouth. The Technology Innovation Centre (TIC) is also in Dartmouth, and is one of two incubation facilities operated by InNOVAcorp. The financial position and operating results of TIC are fully consolidated with InNOVAcorp. The company's other incubation

facility, BioScience Enterprise Centre Incorporated is located in Halifax, in a facility owned by another crown corporation (Waterfront Development Corporation). InNOVAcorp also owns 77% of a subsidiary company, The Decision Point (TDP). The financial position and operating results of TDP are fully consolidated with InNOVAcorp. The Corporation employs 47 staff, including 10 at its incubation facilities.

14.5 We conducted this audit under Section 15 of the Auditor General Act. This was our first broad scope audit of the Nova Scotia Innovation Corporation. We conducted a broad scope audit of the Nova Scotia Research Foundation Corporation in 1994. The Auditor General is the financial statement auditor for InNOVAcorp.

RESULTS IN BRIEF

14.6 The following are the principal observations from this audit.

- We concluded that many of the audit criteria, used to assess whether our overall audit objectives were achieved, were met, particularly with respect to the governance and accountability functions. However, corporate policies and procedures require updating to better reflect the changed strategy and focus of InNOVAcorp.
- Terms of reference for the Investment Review Committee should be documented and approved by the Board of Directors. The terms of reference should include authorization limits, meeting protocols and roles and responsibilities. Terms of reference should also detail the nature and frequency of reporting to the Board.
- The Board should identify and approve roles and responsibilities for Officers of the Corporation. Authorization limits should also be established.
- Senior management should review and update the program administration guidelines for the Nova Scotia First Fund. These guidelines should include investment eligibility criteria, and should clearly differentiate the policies related to uncommitted funds. The guidelines should be approved by the Board as it has overall responsibility for administration of the Fund.
- A system to monitor, measure and report on performance should be developed. Focus should be given to those areas which are critical to the success of, or represent a significant risk to, InNOVAcorp's mission.
- Criteria upon which bonuses are based should be clearly defined and communicated to the employees in question. There should be formal, documented evaluations against these criteria to support the determination of bonuses.

- Any costs associated with the investment or services provided to InNOVAcorp's subsidiary, The Decision Point, should be included in InNOVAcorp's operating results.
- InNOVAcorp should update the documentation of its procurement policies and procedures. These policies and procedures should be compatible with Provincial requirements, detail when a competitive process is required, and address the use of purchasing cards.

14.7 Subsequent to completion of our audit, management informed us that progress had been made toward implementing the above recommendations. For example, updated terms of reference have been drafted for the Investment Review Committee, and roles and responsibilities for corporate officers have been drafted in connection with an overall policy related to delegation of authority. An updated investment policy has also been drafted. Procurement policies and procedures are to be updated to reflect current InNOVAcorp strategy, and to be compatible with Provincial procurement policies and procedures. Management has further indicated that a performance management system has been developed. We have not verified any of these representations made by management.

AUDIT SCOPE

14.8 We conducted the audit of InNOVAcorp in early 2003. The summary objectives for this assignment were to assess the overall governance, accountability, management and control arrangements for selected aspects of the operations of the Nova Scotia Innovation Corporation, and to conclude whether there is adequate:

- compliance with statutory and other enabling authorities or requirements;
- control systems, procedures and practices; and
- due regard for economy and efficiency.

14.9 Criteria were developed to facilitate our review. These criteria were discussed with senior management at the Corporation prior to the start of the audit and were revised as a result of those discussions.

14.10 Our approach to this assignment consisted of interviews with staff and senior management at InNOVAcorp, the current and former Board Chairs, and the Chair of the Investment Review Committee. We also met with the Chief Executive Officer of the Office of Economic Development. We reviewed minutes for the period under audit (April 1, 2001 to December 31, 2002), and examined documentation relevant to our assessment of the audit criteria. In addition, we conducted a governance survey of all members of the Board of Directors and of the Investment Review Committee. The results of that survey are noted in paragraph 14.18 below. Relevant comments and observations resulting from the survey have been noted throughout the chapter.

PRINCIPAL FINDINGS

Governance and Accountability

14.11 **Summary** - We concluded that many of the audit criteria used to assess the governance and accountability functions were met. For example, the Corporation has a vision and mission which are reaffirmed during the annual planning process, and which are consistent with the Innovation Corporation Act. The Board meets as required by legislation, and a review of Board meeting minutes indicates the Board is focused on the direction of the Corporation.

14.12 There were audit criteria which we determined as being only partially met, or not met. The following paragraphs focus on the most significant observations resulting from our assessment of these criteria.

14.13 **Investment Review Committee** - The Investment Review Committee was established in 1996 under the program management guidelines for the Nova Scotia First Fund. These guidelines were approved by InNOVAcorp's Board of Directors and consequently the Committee is viewed as a committee of the Board.

14.14 There are several findings with respect to the Investment Review Committee.

- There are no terms of reference for the Investment Review Committee. The NSFF's program management guidelines note that the Committee is to approve projects receiving funding. However, the guidelines do not identify roles and responsibilities for the Committee such as approval limits.

In addition, administrative guidelines for the Committee have not been documented. These would include number and frequency of meetings, number of votes needed for a quorum, and specify the procedures to be followed when a meeting is conducted through e-mail. Although our review of Committee minutes revealed that various guidelines have been established over time, they should be formalized and approved by the Board as part of the Committee's terms of reference.

Finally, the guidelines do not specify whether the Committee should report to the Board on its activities. We noted that information is provided to the Board at each of its meetings on the status of the various investments. This information is provided by staff, not by the Committee. It is our view that there should be a more formal reporting process between the Committee and the Board, given that the Board has delegated responsibility for administering the Fund to the Committee.

- A sub-committee was established by the Investment Review Committee to approve certain investments. Because the Investment Review Committee does not have terms of reference, the authority under which it was able to establish this sub-committee, and delegate authority to it, is unclear.

- Conflict of interest guidelines were approved by the Investment Review Committee. A member of the Committee suggested that these guidelines be updated on an annual basis, but this has not been done.
- The Committee includes members of the Board and four individuals who are not members of the Board. We were informed the membership was expanded in this way to provide additional expertise and objectivity to the investment approval process.
- The program management guidelines for the NSFF establish the members of the Committee. The guidelines note that one private sector member who is “project specific” may be added to the Committee. The decision to expand the Committee to include private sector individuals on an ongoing basis was not approved by the Board.

Recommendation 14.1

We recommend that terms of reference for the Investment Review Committee should be documented and approved by the Board of Directors. The terms of reference should include authorization limits, meeting protocols and roles and responsibilities, as well as formalize the reporting process between the Committee and the Board.

14.15 **Corporate officers** - The Corporation’s bylaws provide that the Board can appoint officers. We noted approval of the slate of officers submitted for approval at each of the annual meetings during the period of our audit.

14.16 Roles and responsibilities for these officers have not been established and approved by the Board and we recommend this be done. In particular, we recommend that authorization limits be established. This practice would be consistent with other Provincial entities that provide economic assistance to businesses through loans, investment and other mechanisms.

Recommendation 14.2

We recommend that the Board identify roles and responsibilities for officers of the Corporation. Authorization limits should also be established.

14.17 **Other governance issues** - The following are additional observations on overall governance matters.

- There are no conflict of interest guidelines for the Board of Directors. Guidelines should be established and approved by the Board, and updated on an annual basis.

- The Board has established a Nominating Committee. Formal terms of reference have not been approved by the Board although the roles and responsibilities of the Committee appear to be clear. Minutes are not kept of the Committee's proceedings and we suggest this be done.
- Although the Corporation appears to follow appropriate business practices in its day-to-day operations, policies and procedures related to business activities have not been documented, or existing documentation is not current. Senior management has indicated documentation of policies and procedures has not been a priority as the Corporation continues its transformation from NSRF activities to InNOVAcorp's three core business areas.

The Province recently released revised Management Manuals. The corporate administrative policies and procedures contained therein are applicable to crown corporations to the extent they do not conflict with their existing practices. InNOVAcorp should document its policies and procedures to ensure they reflect the Corporation's activities or adopt the Provincial Management Manuals.

14.18 **Governance survey** - We conducted a survey of members of the Board of Directors, and included in this process those members of the Investment Review Committee who are not members of the Board. There was a 36% response rate. We also conducted interviews with the current and past Board Chairs. The following are the more significant observations resulting from these processes.

- Board members are satisfied with the extent of communication from the Office of Economic Development. They are clear on the direction of the Corporation and its role in the Province's overall economic development strategy.
- Board members also indicated they are satisfied with the frequency and content of reports received from management on the operating and financial results of the Corporation.
- One of the questions posed in the survey was whether the Board has undertaken a self-assessment process. The responses indicated this has not been done. We suggest the Board conduct a periodic review on all matters of corporate governance.
- An evaluation of the Chief Executive Officer was conducted during the period of time audited. Survey results indicate this is a regular process. However, the process does not include documented goals and objectives for the CEO, and a related evaluation of results achieved.

14.19 **Accountability** - The governance and accountability framework of the Corporation is detailed in Exhibit 14.1. In prior years, the Corporation prepared its Annual Report by September 30 in accordance with Section 21 of its Act. However, since 2000, the annual reporting process has been altered due to changes in other legislation. For example:

- The Corporation's audited financial statements were included in its Annual Report as required by the Act. These financial statements are now required by June 30 each year for publication in Volume I of the Public Accounts. As a result, the Corporation now publishes an annual review that does not include its financial statements. The Corporation provides its financial statements to interested parties.
- As a crown corporation, InNOVAcorp is now required to prepare an annual accountability report in accordance with the Provincial Finance Act. Guidelines for the preparation of the accountability report are provided by Treasury and Policy Board (T&PB). The guidelines indicate that the accountability report will replace the annual report for those entities which prepare an annual report. However, the timing of T&PB's accountability report publication is late and would not achieve technical compliance with InNOVAcorp's September 30 deadline.

14.20 It is apparent that other legislation is superceding the requirements of the Innovation Corporation Act. The requirement to produce an accountability report rather than an annual report as noted above has also been observed in other entities during assignments conducted by our Office. We suggest that government consider revising existing legislation of affected entities to ensure reporting requirements are made consistent with overall government reporting requirements.

Business Line and Performance Management

- 14.21** **Summary** - We evaluated the processes supporting the preparation of annual plans and budgets at InNOVAcorp, as well as those related to periodic financial reporting, forecasting and monitoring. We also evaluated the performance management systems at the Corporation. Our comments with respect to these areas are noted below.
- 14.22** **Planning, budgeting and reporting** - Monthly financial results including budget forecasts to year end are provided to senior management. Interviews with these individuals indicate the frequency and content of these reports are adequate. We noted that the Board receives information on investment results at each of its meetings. As noted in paragraph 14.18 above, Board members also indicated that they are satisfied with this reporting format.
- 14.23** **Performance management** - As noted in paragraph 14.19 above, the government's annual reporting requirement for crown corporations has been replaced by an accountability report. As this process evolves, entities will be required to provide measurable targets in annual business plans, and report on progress toward meeting targets.
- 14.24** A formal performance management system has yet to be developed at InNOVAcorp. The 2002-03 and 2003-04 business plans for InNOVAcorp include outcome

measures, but management acknowledges these are not used to actually manage or monitor performance on an ongoing basis at this point in time.

Recommendation 14.3

We recommend that a system to monitor, measure and report on performance be developed. Focus should be given to those areas which are critical to the success of, or represent a significant risk to, InNOVAcorp.

- 14.25** **Management compensation** - At the time of our audit, bonuses had been accrued for the year ended March 31, 2002 but not paid. We reviewed the process for determining bonuses to eligible members of senior management. It had yet to be determined whether bonuses would be awarded based on March 31, 2003 results.
- 14.26** Criteria used to evaluate bonuses for the period were not documented, although we were informed the relevant individuals were well aware of their performance goals and objectives. Management indicated they were using a less formal process due to changes in the organizational structure of InNOVAcorp, but that they intended to implement a more formal process during the current fiscal year (i.e., 2003-04). This process should be part of the overall performance management system at InNOVAcorp.

Recommendation 14.4

We recommend that criteria upon which bonuses are to be based should be clearly defined and communicated to the eligible employees. Evaluation against these criteria should be documented.

- 14.27** **The Decision Point** - The Decision Point is a subsidiary company of InNOVAcorp. TDP is developing on-line, web-based mentoring services. The company was established in late 2000 and has an office in Dartmouth (located in the main InNOVAcorp facility) and in Toronto (located in the office of another shareholder).
- 14.28** We identified the following instances where TDP operations are being subsidized by InNOVAcorp.
- InNOVAcorp owns 77% of The Decision Point and has financed its interest in TDP through shareholder loans. These are non-interest bearing loans and have no specified terms of repayment.
 - InNOVAcorp does not charge rent for the office space used by TDP at InNOVAcorp's head office.

- 14.29** The financial position and operating results of TDP are fully consolidated with InNOVAcorp and therefore inter-company transactions are eliminated on consolidation. However, any services provided by InNOVAcorp but not charged to TDP provide a benefit to TDP's minority shareholders. Under the current accounting method, the costs of the services contributed to TDP cannot be determined from InNOVAcorp's financial statements.

Recommendation 14.5

We recommend that any costs associated with the investment or services provided to InNOVAcorp's subsidiary, The Decision Point, be separately disclosed in InNOVAcorp's operating results.

Investment Management

- 14.30** **Summary** - Criteria, used to assess the overall objectives of the investment management function at InNOVAcorp and the linkage between these objectives and corporate objectives, were met. The following observations relate to criteria assessing administrative aspects of the investment management function.
- 14.31** **Nova Scotia First Fund** - The Nova Scotia First Fund was established in 1989 to assist technology-based companies. As noted previously, the administration of the Fund was transferred to InNOVAcorp through the Innovation Corporation Act, and program management guidelines were approved by the InNOVAcorp Board of Directors in February 1996. A summary of the Fund's activities, extracted from the Corporation's audited financial statements, is included in Exhibit 14.2. The balance of the Fund at March 31, 2002, net of the valuation allowance, was \$9,393,115.
- 14.32** Projects are approved by an Investment Review Committee as noted in paragraph 14.14 above. The following are our comments with respect to the guidelines and overall administration of the NSFF.

- The guidelines for the NSFF include eligibility criteria. We tested eight investments representing 71% of the total portfolio to determine whether the initial investment was made in accordance with these criteria. We found no significant instances of non-compliance.

The eligibility criteria are broad. For example, one criterion notes that a project must be financially viable based on realistic projections. However, the term "viable" is not defined and therefore may be open to interpretation.

The NSFF recently received an additional \$8.0 million. It would be appropriate for the Board to consider a review of the guidelines to determine relevance and whether they still reflect InNOVAcorp's strategy, especially since the additional investment funds are available. The guidelines should also include criteria

for follow-on investments (i.e., additional amounts related to an existing investment).

- The guidelines note that the investment policy for the uncommitted portion of the Fund should include an appropriate mix of fixed return and equity investments. A related investment policy was developed and approved by the Board in 1997, and reviewed and amended in 2000. The policy includes objectives, an allocation strategy and investment quality guidelines.

The Board is provided with a report which summarizes compliance with this investment policy at each of its meetings. We tested the conclusions of these reports and noted that the conclusions were supported by the information included in the report.

The policy requires review and update on a periodic basis and we found this has not been done.

- Although the guidelines include overall objectives for the NSFF, management indicated there has not been an assessment to determine whether these objectives have been met. We suggest this be done as part of the overall performance management process for the Corporation.

Recommendation 14.6

We recommend that senior management review the program administration guidelines for the Nova Scotia First Fund. These guidelines should include investment eligibility criteria, and should clearly differentiate the policies related to uncommitted funds. The guidelines should be approved by the Board as it has overall responsibility for administration of the Fund.

Procurement

- 14.33** **Summary** - As a crown corporation, InNOVAcorp is required to follow guidelines outlined in the *Government Procurement Process - ASH Sector*. This requires that procurement processes and practices are open, fair, and subject to the policy objectives laid out in the procurement policy.
- 14.34** We reviewed InNOVAcorp's procurement policies and procedures for purchasing goods and services, and for the procurement of services related to consultants and professionals.
- 14.35** We found the documentation of these policies and procedures out-of-date. For example, the policies still make reference to the purchasing department which no longer exists and there is no mention of the use of Purchase Order (PO) cards. PO cards are used by all staff members for purchasing items up to an authorized limit. Telephone and cellular phone charges are charged to these cards as well.

14.36 **Transaction testing** - We selected a sample of items related to the following types of transactions:

- ongoing goods or services for which a standing order with a supplier is expected;
- one-of-a-kind purchases of goods or services which require a competitive process; and
- professional services which also require a competitive process.

14.37 The objective of our testing was to determine if InNOVAcorp was in compliance with government procurement practices. The results of our testing indicated that a competitive process was not used to the extent required. In addition, we noted that professional services were obtained through alternative procurement practices. These practices require that there is documentation to support goods or services obtained through sole-source arrangements. There was no documentation providing rationale for the decision to sole-source these transactions.

14.38 We spoke with a representative from the Procurement Branch of the Department of Transportation and Public Works regarding the process to obtain a standing order from a supplier. Standing orders are obtained by the Province as the result of a competitive process. This ensures the best price is obtained for regular, recurring purchases. These orders protect against price increases, and departments are encouraged to use these suppliers. We suggest that InNOVAcorp consider using standing orders to obtain recurring goods and services.

Recommendation 14.7

We recommend that InNOVAcorp update the documentation for its procurement policies and procedures. These policies and procedures should be compatible with Provincial requirements, detail when a competitive process is required, and address the use of purchasing cards.

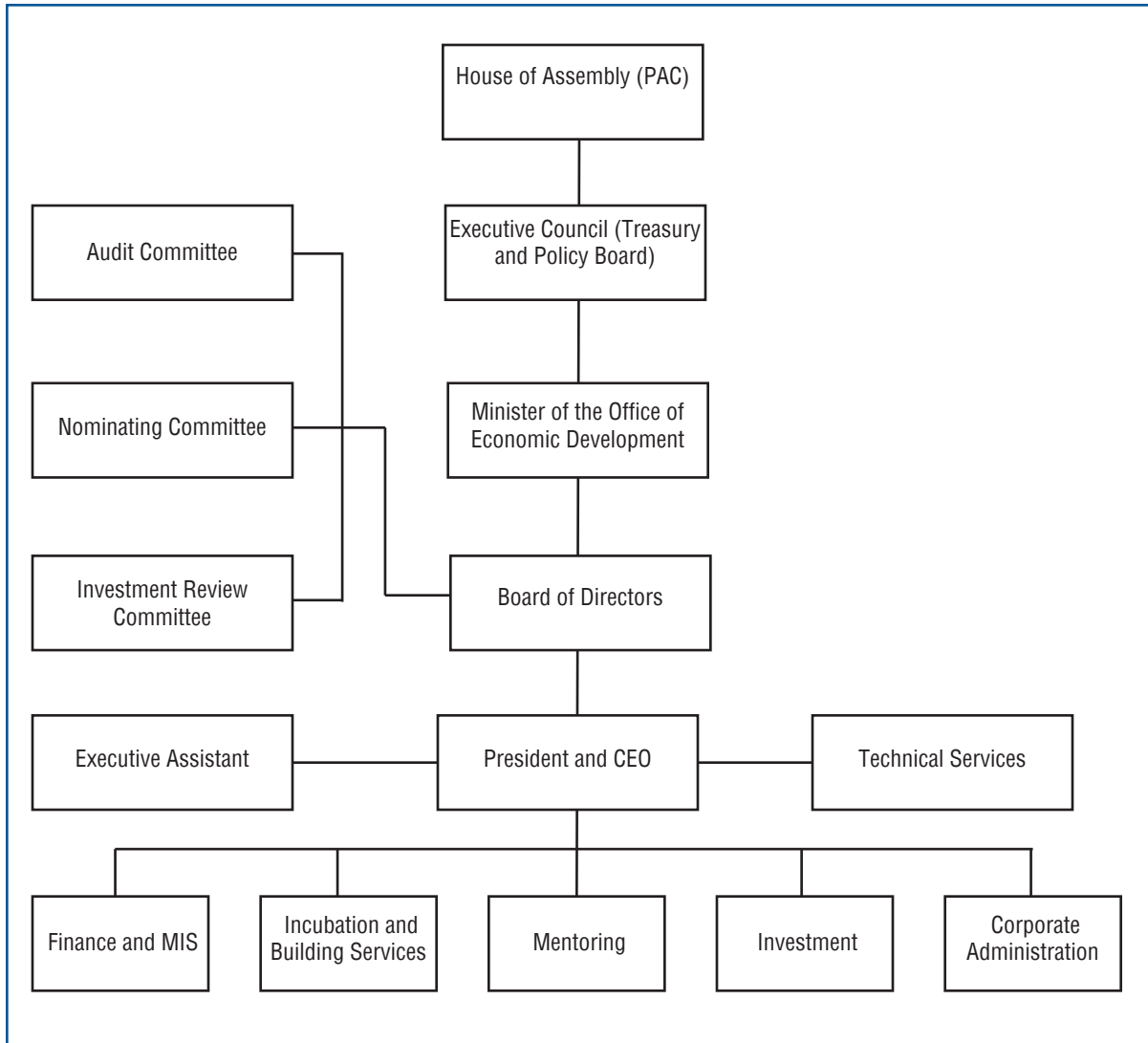
CONCLUDING REMARKS

14.39 The Nova Scotia Innovation Corporation has undergone significant changes since its creation in 1994. The focus of the Corporation has shifted from manufacturing and related activities to providing services, including equity financing and facilities, to start-up and established companies in the technology sector.

14.40 This was our first review of InNOVAcorp since it was established. The Board of Directors, management and staff of the Corporation appear to have a vision for the Corporation which is consistent with legislation and with the overall government economic development strategy. We encourage the Corporation to review and update existing policies and procedures to ensure they reflect current practices. We also encourage the Corporation to develop a system to monitor and evaluate its performance in order to assess whether established objectives have been met.

Nova Scotia Innovation Corporation - Governance and Accountability Chart

Exhibit 14.1



Nova Scotia First Fund - Summary of Activity 1997-2002

