Chapter 2: Corporate Governance

Why we did this audit:

- Large Crown corporation owned by four provinces makes good governance and oversight critical
- ALC is facing significant market changes
- Operates in and provides regulated service
- Four governments depend on this annual revenue

Overall conclusions:

- The current governance framework is not equipped to deal with challenges facing ALC and shareholder governments
- ALC Board was not always provided with sufficient and timely information for effective decision making
- ALC Board composition is challenging effective operations of ALC
- The ALC Board adopted governance best practices and is improving
- We made eight recommendations to shareholder governments, five to ALC Board

What we found in our audit:

Governance and Oversight

- Not all shareholders provide direction to ALC on its mandate
- Shareholder governments have not regularly reviewed the Unanimous Shareholder Agreement, the basis for corporate action

Accountability and Authority

- Shareholder governments have not defined the roles and responsibilities of ALC and governments
- Some shareholder governments have not provided clear and timely performance expectations
- Some shareholder governments have not given the Board sufficient autonomy to govern ALC
- Unclear accountability allows for disruptive government intervention of business practices

Board Governance

- Board governing with many best practices
  - Independent Chair in place
  - Board self-evaluating and assessing
- Board is not at arm's length from governments
- Board did not evaluate reputational risk

Illustrative Examples

- Techlink – NS ordered ALC to override business processes and advance $1.26 million to Techlink
- Geonomics – Board failed to consider risks and get all information such as the investee's cash shortage
- Internet gaming – Corporation lost $640,000 after governments said no-go to this

Management

- Didn't provide all information to the ALC Board, $8 million investment lost

Recommendations at a Glance	Shareholder Responses
Eight recommendations to the four shareholder governments **Note: Recommendation numbers below refer to the recommendation number in the body of the report and therefore may not be sequential.**	
Recommendation 2.1 The shareholder governments should complete an indepth review of ALC's mandate that considers how the Corporation fits into each government's gaming policy and public policy objectives and the organizational structures required to achieve these. Based on this review, Atlantic Lottery Corporation's mandate should be updated as required.	*Agree. ALC's mandate is currently derived from multiple sources including Legislation, Regulations, agreements and policies. It recognizes the complex nature of operating a corporation that is jointly owned by provincial governments, and respects the right of each Province to establish its own policy for gaming and responsibility to conduct and manage gaming as required under the Criminal Code. The Shareholders will, over the next year, review gaming policy and public policy objectives with the goal to articulate a high level mandate for ALC that appropriately takes into account the different statutory and policy frameworks in each Province.*
Recommendation 2.2 Shareholder governments should periodically review the Unanimous Shareholder Agreement and Corporate By-Laws and revise as warranted.	*Agree. The Shareholders agree that the USA and by-laws need to be reviewed regularly and where possible in accordance with provisions within each respective document. The by-laws were last reviewed and updated in 2015 with changes approved by the Shareholders in 2016.* *The by-laws were updated by the shareholders and approved by the ALC Board in 2016.* *The Shareholders are currently working to update the USA.*
Recommendation 2.3 Shareholder governments should routinely collaborate and give ALC regular and timely policy direction for ALC to use in its strategic and business planning process.	*Agree. The shareholders agree with this recommendation and over the next year, will discuss means to achieve it.*
Recommendation 2.4 Shareholder governments should define and document their roles, responsibilities and authorities for oversight of ALC. Each shareholder government should clarify the relationships between the Board, the responsible Minister, and other government representatives.	*Agree. Although roles, responsibilities and authorities exist in each Province, the Shareholders agree that over the next year a formal documented framework should be developed.*
Recommendation 2.5 Shareholder governments should define formal performance expectations for ALC that are clear and publicly communicated. These performance expectations should be updated annually as part of the shareholder governments' oversight and strategic direction.	*Agree. This recommendation will be given consideration in the development and implementation of the process to address the above recommendations.*

Recommendations at a Glance	Shareholder Responses
Recommendation 2.7 Within the accountability framework, shareholder governments should clarify which level of government authority (Deputy Minister, Minister, Cabinet or Order in Council) ALC requires to enter into transactions.	*Agree. Although roles, responsibilities and authorities exist in each Province, the Shareholders agree that over the next year a formal documented framework should be developed.*
Recommendation 2.12 Shareholder governments should authorize updated governance structures and processes to reflect best practices for the composition and appointment of Directors, including: • A Board selection process that is competency-based, professional, competitive, open, transparent and reflective of the skill requirements for the Board and the needs and practices of each shareholder; • Shareholders appoint voting Board directors for a fixed term greater than one year, subject to renewal; and, • Board members should not be elected officials nor employees of Government.	*Agree / Disagree. Shareholders are currently updating processes and governance structures to appoint Board members for ALC. The by-laws have recently been updated to allow Shareholders to nominate up to two independent directors who are not government employees or elected officials and up to one non-independent director. These directors will serve staggered terms of three years.* *Given the depth and breadth of the recommendations in this report the Shareholders believe that it is in their best interests to continue to have a government representative at the board.*
Recommendation 2.13 Shareholder governments should change the role of public servants (i.e., government shareholder representatives) on the ALC Board to be non-voting, ex officio members in accordance with best practice.	*Disagree. See response to 2.12. The Shareholders may be willing to revisit this recommendation once the work on the other recommendations in regard to governance has been completed, any resulting changes implemented, and the effectiveness of those changes monitored and evaluated.*

Recommendations at a Glance	Board of Directors Response
Five Recommendations to Atlantic Lottery's Board of Directors	
Recommendation 2.6 The ALC Board should set performance targets that are measurable indicators of planned outcomes, as well as incorporating relevant industry performance benchmarks. Actual performance against these targets should be publicly reported annually.	*Agree. With full Board oversight, the Corporation has long operated under a well-defined Balanced Scorecard that has served to provide clear and measurable targets. As of September, 2016, ALC will publicly report against BSC results in its annual report. Earlier this year, the Board directed Management to construct for review an industry benchmarking framework comparing the performance of ALC to industry peers. It is the intent to have benchmarking in place for the 17/18 fiscal year.*
Recommendation 2.8 The ALC Board should separately report in the Corporation's annual report any decisions taken by a shareholder government that would otherwise contravene a Board decision or established business practices.	*Agree. ALC will adopt this practice beginning with the 2017/18 annual report. ALC respects Shareholder authority and rights established under provincial gaming legislation.*
Recommendation 2.9 When evaluating new or unusual business ventures, the ALC Board should critically evaluate the relevant experience and skill sets on the Board. As needed, the Board should supplement missing skills with contracted, independent, third-party support.	*Agree. It is now the Boards practice to engage third party, independent advice for major investment decisions to evaluate and mitigate risk and to compensate for specific skill or experience deficiencies.*
Recommendation 2.10 The ALC Board should ensure risks are properly assessed and mitigated to an acceptable level before making investment decisions. It should also ensure that future business venture decisions are aligned with shareholder governments' priorities, policies and tolerance for risk before proceeding.	*Agree. The Board appreciates the observations and are pleased to report that more robust risk management practices including alignment with Shareholder Governments before making investment decisions are now in place. The Board will continue to ensure risks are properly assessed and mitigated, and will continue to seek third party advice where an independent assessment would enhance decision making.*
Recommendation 2.11 The ALC Board should ensure it obtains sufficient and appropriate information from management to adequately assess the potential risks, rewards, and appropriateness of future proposed initiatives.	*Agree. The Board is concerned with the observations in the report and will follow up on them. The Board has a high degree of confidence that it receives timely, sufficient, and appropriate information from Management. The Corporation benefits from transparent relations between Management and the Board, where vetting assumptions is the norm.*

2 Corporate Governance

Background

2.1 In 1976, the governments of New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island approved the incorporation of the Atlantic Lottery Corporation under the Canada Business Corporations Act. Atlantic Lottery was incorporated to be a cooperative venture between the four Atlantic Provinces and designated as an agent of the Crown to conduct and manage lottery schemes. Each province is an equal shareholder in the Corporation.

2.2 The Corporation is overseen by a nine-person Board of Directors. Each province appoints two members with voting rights and the Board appoints an independent, non-voting chair. An overview of the shareholders and ministers responsible in each province is outlined in Exhibit 2.1 below.

Exhibit 2.1

Province	Responsible Minister	Shareholder
New Brunswick	Minister of Finance	New Brunswick Lotteries and Gaming Corporation (NBLGC)
Newfoundland and Labrador	Minister of Finance	Province of Newfoundland and Labrador
Nova Scotia	Minister of Energy	Nova Scotia Provincial Lotteries and Casino Corporation (NSPLCC)
Prince Edward Island	Minister of Finance	Prince Edward Island Lotteries Commission

2.3 Atlantic Lottery Corporation's gaming products include lotteries, instant games (scratch and break-open tickets), video lotteries, online games, sports betting, and the Red Shores Casino on Prince Edward Island. Gaming revenues are credited to the province in which they are earned. Costs that are directly attributable to a province are charged to that province and indirect gaming costs are distributed to the provinces based on the proportion of gaming revenues within each province. Common costs, such as overhead, are allocated among the provinces as follows: New Brunswick, Newfoundland and Labrador, and Nova Scotia – 30 percent each; Prince Edward Island – 10 percent. Exhibit 2.2 notes annual revenue and profits for the Corporation between 2010-11 and 2014-15.

Exhibit 2.2

Annual Revenue and Profits ($ millions)					
	2010-11	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Revenue	$1,073	$1,057	$1,048	$1,065	$1,068
Profit per shareholder					
New Brunswick	$122	$120	$120	$119	$116
Newfoundland and Labrador	$106	$108	$114	$123	$129
Nova Scotia	$130	$127	$112	$111	$113
Prince Edward Island	$13	$15	$15	$15	$10
Total Profit	$371	$370	$361	$368	$368

2.4 Atlantic Lottery has delivered significant profits to shareholder governments over the past 40 years. Increased competition from online and other forms of gaming have resulted in new challenges that impact the Corporation's ability to maintain and grow profits. Over the past five years, revenue and profit have been relatively consistent from year to year.

2.5 For information, key highlights over the past five years from Atlantic Lottery's statement of financial position are outlined in the exhibit below.

Exhibit 2.3

Statement of Financial Position Highlights ($ millions)					
	2010-11	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Assets					
Capital asset	$103,525	$61,047	$126,484	$122,094	$108,024
Other	$74,697	$115,823	$131,917	$128,844	$121,773
Total assets	**$178,222**	**$176,870**	**$258,401**	**$250,938**	**$229,797**
Liabilities					
Debt	$116,457	$121,612	$216,010	$193,786	$194,736
Accounts payable	$25,900	$30,480	$22,151	$32,718	$17,339
Other liabilities	$37,216	$71,570	$85,411	$58,338	$53,912
Total liabilities	**$179,573**	**$223,662**	**$323,572**	**$284,842**	**$265,987**

Audit Objectives and Scope

2.6 The objective of the audit was to determine whether Atlantic Lottery Corporation's governance structures and processes create a framework for effective governance and are working well.

2.7 The scope of this audit included the oversight and governance of ALC. The role of government in regulating lotteries and gaming was considered to be outside the scope of this audit.

2.8 The audit criteria were adapted for this engagement from criteria used by legislative auditors in other jurisdictions as well as guidance from the Canadian Council of Legislative Auditors. The audit criteria were discussed and accepted as appropriate by ALC management and the Board. The criteria used can be found in Appendix I.

2.9 Our audit approach included documentation review, analysis, surveys and interviews. Observations and conclusions were formed based on:

- interviews with current and former Board members, senior executives and elected officials within each shareholder government;
- responses to our governance survey of Board members;
- review of ALC Board minutes, and shareholder meetings for the period 2013 through 2015;
- examination of legislation (Appendix III) and policies as relevant; and,
- review of pertinent reports and presentations including those prepared by and for ALC management, the Board and shareholder governments.

Audit Conclusion

2.10 Overall, we found the governance framework under which the Atlantic Lottery Corporation operates is not equipped to deal with current and future challenges facing the entity and shareholder governments. The gaming environment is evolving rapidly due to increased competition brought on by changes in technology, demographics and consumer tastes. The weaknesses identified in governance and oversight have resulted in increased risk to ALC and individual governments; lowered opportunity for increased revenue distribution to the shareholder governments; and potential loss of market relevance of ALC in the future.

2.11 The ALC Board has adopted many governance best practices and demonstrated continuous improvement. However, the Board appointment process presents challenges to effective operations. The fact that not all ALC Board members are independent of government can have a negative impact on the Board's effectiveness and may limit the organization's future success. Further, shareholder governments and management have not always provided the Board with sufficient and timely information for effective decision making.

What is Governance?

2.12 Governance refers to the structures and processes for overseeing the direction and management of a corporation so that it carries out its mandate and objectives effectively. Clarity of objectives and expectations, clear lines of accountability, and transparency are required elements in a sound governance system.

Oversight and governance of a Crown agency means that accountability to government needs to be balanced with the entity's need for operational independence

Source: Shareholder's Expectations for British Columbia Crown Agencies, Crown Agencies Resource Office, Ministry of Finance, 2011, pg 4.

2.13 Effective Crown agency governance requires a balanced framework. The Crown agency must be accountable and transparent, and its policies and actions must reflect government's policies and expectations. However, this must be balanced with the agency's need to make independent decisions within its mandate. For Crown entities such as ALC, there are several participants involved in the discharge of government's responsibilities including:

- Cabinet;
- the responsible Ministers;
- Deputy Minister(s) and departments; and
- Provincial gaming commissions and corporations.

2.14 In the case of ALC, this is further complicated by the fact that it is owned by four governments. Three of the four governments have also created a separate entity within their province to manage lotteries and gaming. The four ownership shares in ALC are nominally held on behalf of the respective governments by provincial Crown agencies and the Department of Finance of Newfoundland and Labrador.

Significant Audit Observations

Shareholder Government Oversight and Control

Conclusion and summary of observations

We found shareholder governments have not completed a joint review of ALC's mandate since 2007. Clear, up-to-date mandate direction from shareholder governments is critical to efficient and effective operations. Given recent dynamic market changes, and the resulting challenges and opportunities this represents for the organization, revisiting the ALC mandate is necessary. At this point, the mandate under which the Corporation operates is not well-defined. A clear mandate will help ensure ALC operates within the boundaries intended by the four shareholder governments and, where considered appropriate, has the authority to address new challenges and opportunities.

2.15 *Mandate is not clear* – We found the mandate of Atlantic Lottery is not clear in light of the complex structure and varied government expectations. ALC is responsible to four shareholder governments, each having its own policy direction, while operating in a rapidly changing gaming environment. ALC's complex mandate comes from multiple sources including:

- Unanimous Shareholder Agreement (USA)
- Four sets of provincial gaming legislation
- Three provincial gaming strategies (New Brunswick, Nova Scotia, Prince Edward Island) and related policies
- ALC mandate statement in its annual report
- Mandate letter (signed by 3 provinces; New Brunswick, Newfoundland and Labrador, and Prince Edward Island)
- ALC agency agreement with Nova Scotia Provincial Lotteries and Casino Corporation

2.16 Unlike a private sector business which can set its own mandate, ALC, a government-owned Crown corporation, receives its mandate from the four shareholder governments. In most cases, this direction would come through enabling legislation. In the case of ALC, owned by four provinces, it does not have its own specific, enabling legislation. Each province has its own gaming legislation that allows the government and its agents to enter into partnerships with other provinces.

2.17 It is under the authority of provincial gaming acts that the four provincial governments have come together and agreed to *"cooperate to develop, organize and undertake lottery schemes within the Atlantic Provinces*[1]*."* The Unanimous Shareholder Agreement gives ALC a mandate to either:

- manage, conduct and operate lotteries and gaming on behalf of the provinces; or
- operate lotteries and gaming in the province.

Atlantic Lottery Corporation has adopted a mandate which is broader than the Unanimous Shareholder Agreement

2.18 As part of its strategic and business planning, ALC has developed its own mandate statement: *"to provide safe and responsible products for those Atlantic Canadians who choose to game and, through that effort, deliver optimized and responsible profits to the shareholders."* This wording borrows elements found in legislation in both Nova Scotia and New Brunswick. It is a broader, more comprehensive statement than what is stated in the Unanimous Shareholder Agreement. The mandate derived by ALC includes an element of responsible gaming (social responsibility) and delivery of optimized profits in the provision of gaming products, and is not specifically restricted to lotteries and gaming.

2.19 As indicated, each of the four provinces has its own distinct legislation and regulations governing the conduct of lotteries and gaming within the province. This has created different organizational structures within each province for delivering on the province's responsibility for managing and conducting lotteries and gaming. New Brunswick, Nova Scotia, and Prince Edward Island each have a provincial Crown corporation responsible for conducting and managing lotteries and gaming on behalf of the province. Newfoundland and Labrador's relationship with ALC is simplified as it is directly through its Department of Finance. In addition to ALC's gaming operations, New Brunswick, Nova Scotia and Prince Edward Island each have a casino(s). In Nova Scotia and New Brunswick, the casinos are operated by a third party, while in Prince Edward Island the casino is managed by ALC.

Three of four shareholder governments (New Brunswick, Newfoundland and Labrador, and Prince Edward Island) signed a mandate letter in 2014-15

2.20 In recognition of the need for clarity of purpose, scope and direction, ALC drafted a mandate letter with the stated purpose to set out the intentions and expectations of participating shareholder governments with respect to ALC. It included governance and operating principles leading to a corporate mission statement:

[1] *Amended and Restated Unanimous Shareholders Agreement, 2000, Section 9*

> *"To provide safe, regulated and sustainable lottery and gaming options for Atlantic Canadian residents in line with applicable provincial legislation and regulations and through its operations to optimize economic contribution to the Shareholders through its annual dividends and its economic contribution to the region."*

2.21 The mandate letter was signed by the responsible Minister of three of the four shareholder governments (New Brunswick, Newfoundland and Labrador, and Prince Edward Island) in 2014 and 2015. This was more a letter of intent as it did not create any binding obligations on the provinces. Putting the principles, roles and responsibilities found in the letter into effect would require amending the Unanimous Shareholder Agreement and the Corporate By-Laws. However, this was not done.

2.22 It is important that ALC have a clear and consistent mandate. This would clearly outline to ALC the autonomy it has to make appropriate and timely business decisions, within the boundaries established by the four shareholder provinces. In conjunction with an appropriate accountability reporting structure, this would also allow governments to maintain an appropriate arm's length distance from the operations of ALC.

Recommendation 2.1

The shareholder governments should complete an indepth review of ALC's mandate that considers how the Corporation fits into each government's gaming policy and public policy objectives, and the organizational structures required to achieve these. Based on this review, Atlantic Lottery Corporation's mandate should be updated as required.

Shareholder Response: *Agree. ALC's mandate is currently derived from multiple sources including Legislation, Regulations, agreements and policies. It recognizes the complex nature of operating a corporation that is jointly owned by provincial governments, and respects the right of each Province to establish its own policy for gaming and responsibility to conduct and manage gaming as required under the Criminal Code. The Shareholders will, over the next year, review gaming policy and public policy objectives with the goal to articulate a high level mandate for ALC that appropriately takes into account the different statutory and policy frameworks in each Province.*

Governments have not recently reviewed and updated the Unanimous Shareholder Agreement

2.23 *Unanimous Shareholder Agreement not reviewed and updated* – We found shareholder governments have not reviewed the Unanimous Shareholder Agreement (USA) regularly to ensure key terms and conditions reflect the current environment at ALC. This is a key governance document which grants ALC its authority and operating mandate. It should set the tone for all other governance documents, such as letter of shareholder expectations and Corporate By-Laws. The agreement, as amended in 2001, stipulates it is to be updated every three years. A review was last completed and approved by shareholders in 2007.

2.24 Since 2007, ALC management and its Board have initiated a review process on two occasions. This preliminary work consisted of reviewing internal business changes and legislative and regulatory changes that may impact the Agreement and profit allocation schedule. It also included discussions with shareholder representatives on any areas of concern they would like included in a scheduled review.

2.25 In 2009, the ALC Board approved amendments which were presented to the shareholders for review but not all shareholders finalized approval of the amendments. In 2012, further review was put on hold pending the governance reform initiatives ALC was pursuing and the impact they would have on the USA. Although ALC has initiated some governance changes, the USA still has not been updated or amended since 2012.

Recommendation 2.2
Shareholder governments should periodically review the Unanimous Shareholder Agreement and Corporate By-Laws and revise as warranted.

Shareholder Response: *Agree. The Shareholders agree that the USA and by-laws need to be reviewed regularly and where possible in accordance with provisions within each respective document. The by-laws were last reviewed and updated in 2015 with changes approved by the Shareholders in 2016.*

The by-laws were updated by the shareholders and approved by the ALC Board in 2016.

The Shareholders are currently working to update the USA.

ALC Strategy not Supported by Shareholder Governments

2.26 *Strategic direction outside scope* – We found a disconnect between ALC's desired commercial strategy of expansion and growth and what shareholder governments were willing to accept and approve in practice. This was the case even though ALC believed their growth strategy was acceptable to the four shareholder governments. Such unclear or inconsistent government direction can lead to significant business inefficiencies and Crown agencies operating outside their approved mandate.

2.27 Atlantic Lottery Corporation's strategy, approved by the Board in 2009, was inconsistent with shareholder government policies and the regulatory framework. It called for aggressive growth with a focus on revenue and profit growth from outside traditional lines of business, geographic expansion outside Atlantic Canada and mobile gaming management. The Board was aware that full implementation was outside of ALC's existing legislative and regulatory framework. The strategy was unanimously approved by ALC's Board, including the designated shareholder government representatives in October 2009. However, despite this, we found shareholder governments did not support subsequent attempts by ALC to implement the strategy. This is an ineffective and inefficient way to oversee a large, publicly-owned corporation.

2.28 Examples of specific initiatives not supported by all four shareholder governments include:

- the investment in Geonomics (formerly Roboreus);
- provision of internet gaming products (e.g., iPoker, iCasino); and,
- provision of offshore consulting services.

2.29 The policy and regulatory changes needed within shareholder governments to allow full implementation of ALC's Board-approved aggressive growth strategy did not happen. The result was some inefficient use of resources as ALC spent over five years developing business initiatives and products in support of related strategic objectives.

2.30 *Reduced collaboration* – We found shareholder provinces have not realized the full benefit of their joint collaboration in ALC. In 1976, ALC began with ticket lottery as its only product line. The gaming industry has evolved and ALC's operations have expanded to include such things as VLTs (video lottery terminals), online sports betting, and casinos. ALC's business model has deviated from its initial intent of joint collaboration by all four provinces to a common service provider where each jurisdiction can select from the products and services offered by ALC. This results in ALC having to sell new gaming products and services to each province. The result has been a loss of economies of scale and critical mass for new products, and in some cases, greater concentration of risk for the participating province(s).

2.31 For example, the Prince Edward Island Government has chosen to have ALC manage and operate Red Shores Casino. The New Brunswick Government, on the other hand, contracts directly with a third party to manage and operate Casino New Brunswick; ALC is not involved.

2.32 In addition, the relationship between the Nova Scotia Provincial Lotteries and Casino Corporation and ALC is unique, and unlike the relationship in the other three provinces. NSPLCC has an agency agreement with ALC. This type of arrangement was provided for under the 2000-updated Unanimous Shareholder's Agreement.

2.33 We noted the Corporation's unique relationship with Nova Scotia compared to the other three provinces poses challenges to ALC. As a result of this, ALC must follow two different directives under the USA. For three of the four owner provinces, ALC operates, conducts, and manages lotteries and gaming on behalf of the provinces. In Nova Scotia, ALC is the operator only. NSPLCC has retained the conduct and manage responsibility and as a result Nova Scotia is more heavily involved in ALC's operations than the other three shareholder governments. This caused inefficiencies for ALC in operating while respecting the agency agreement outlining the relationship.

2.34 NSPLCC and ALC follow their own annual business planning and budgeting processes. NSPLCC sends a letter to the CEO of ALC outlining Nova Scotia's gaming priorities for the upcoming year. ALC then uses this information in developing a business plan and budget for Nova Scotia. This is then incorporated into ALC's business plan and budget for operations in the remaining provinces. This different governance relationship between Nova Scotia and ALC takes additional time and resources.

2.35 In 2013, the ALC Board initiated a Minister's summit. This is a meeting between the responsible Minister from each of the four shareholder governments, the Chair of the Board, and ALC executives. It is an opportunity to discuss and collaborate on the key issues facing ALC and gaming in the provinces. The summit has occurred each year and attendance has been good. All four provinces attended in 2014 and 2015. The structure and function of the summit continues to evolve from an information session to a dialogue between all participants, with identified outcomes and agreement on some of ALC's key issues. However, collective agreement at the summit has not translated into direction from shareholder governments. Also, while ALC's strategy and business plan is presented to the Ministers, their approval or government approval is not required as part of the strategic planning process, and the summit occurs after the current year business plan and strategy have been adopted.

Recommendation 2.3
Shareholder governments should routinely collaborate and give ALC regular and timely policy direction for ALC to use in its strategic and business planning process.

Shareholder Response: Agree. The shareholders agree with this recommendation and over the next year, will discuss means to achieve it.

Accountability Framework

Conclusion and summary of observations

We found the accountability framework was not robust enough to give ALC the ability to make significant business decisions in a timely manner. ALC does not have a solid framework which clearly establishes the processes and structures through which governance and oversight is exercised. The lack of an appropriately defined accountability framework can slow down the decision-making process. It does not currently provide those charged with oversight and control (i.e., shareholder governments) assurance that their public policy objectives and priorities are being met.

2.36 A strong accountability framework will typically include the following key elements:

- defined roles and responsibilities;
- clear and achievable performance expectations; and,
- full and transparent reporting.

2.37 It is important that such a framework be documented so there is a clear and consistent understanding of the framework, even when changes in board membership and within shareholder governments occur.

Weaknesses Noted in the Accountability Framework

2.38 We found the following weakness in the accountability framework:

- Lack of clearly-defined roles and responsibilities for shareholders and shareholder representatives
- Shareholder governments failing to provide clear and timely performance expectations
- Public reporting on performance not meeting recommended practices for public sector entities

2.39 *Roles and responsibilities* – We found the roles of the four provincial governments within the accountability framework have not been established. The mandate letter, drafted in 2014 by ALC for shareholder government signature, included suggestions for participating shareholder government responsibilities such as:

- issue formal management accountability guidelines;
- review and provide input to ALC’s strategic direction; and

- put in place the legislative, regulatory and policy frameworks to enable ALC to meet its approved mandate, recognizing the sovereignty of each province.

2.40 The fact that ALC had to draft its own mandate letter reinforces the lack of clarity regarding the roles of the shareholder governments. In addition, there is a need to define the roles and responsibilities of key players within the shareholder governments. For example, it must be clear what roles and responsibilities will be met by the responsible Minister versus those reserved for Cabinet. This lack of clarity may slow down the decision-making process and cause inefficiencies. For example, it may not always be clear in advance who will be responsible for the final decision when shareholder government input is required. This makes it hard to estimate how long a decision will take and determine how far in advance to begin the process to request a decision.

2.41 It is also important to define the roles and responsibilities of other representatives of shareholder governments involved, including those representing provincial gaming corporations.

2.42 The complexity of ALC being owned by four governments adds to the necessity of a clear and well-documented accountability framework. The roles and responsibilities of all parties should be outlined specifically, without confusion. The framework should outline who is involved, when they are involved, the information to be reviewed and approved, and response timeline. A documented and complete framework for Crown entities also reduces the risk of political interference. It sets clear boundaries that all parties will be held accountable to honour. With four governments involved to varying degrees in the operation of one jointly-owned Crown corporation, this is especially important. Without clarity and a common understanding, each shareholder may act independently and follow different agendas rather than an ALC agenda built on cooperative partnership. This creates the potential for four unilateral relationships in which the Corporation can be pulled in different directions.

Recommendation 2.4
Shareholder governments should define and document their roles, responsibilities and authorities for oversight of ALC. Each shareholder government should clarify the relationships between the Board, the responsible Minister, and other government representatives.

Shareholder Response: *Agree. Although roles, responsibilities and authorities exist in each Province, the Shareholders agree that over the next year a formal documented framework should be developed.*

2.43 We found certain Board members had additional informal responsibilities as de facto shareholder representatives. This unrecognized role contradicts governance best practice and is a source of confusion and tension within ALC's governance framework. The belief that certain directors (appointed public servants) were on the Board to represent a shareholder government and its interests was held by senior management of ALC as well as senior officials in shareholder governments.

2.44 This places those individuals in an awkward and at times conflicting position. As a corporate director, they are required to act in the best interest of the Corporation. However, as a Board-appointed, senior public servant they are also expected to represent and protect the interests of their provincial government. Corporate and individual shareholder government interests are not always the same.

2.45 *Performance expectations* – We found ALC is not provided with clear performance expectations by all shareholders. Profit and growth performance were commonly cited as being most important to the majority of shareholders. NSPLCC, as part of its distinct business planning process with ALC, sends the CEO of ALC a letter each year describing what is expected of ALC for the upcoming fiscal year. In the course of our work, we found numerous other informal expectations of ALC and have listed them below.

2.46 Some expectations of individual shareholder government are unique and may not align with the expectations of the others. For example, Nova Scotia has a policy to reduce the number of VLTs over time, whereas some other shareholders do not have similar policies.

2.47 The following are some of the expectations placed on ALC. The list contains documented expectations from NSPLCC, as well as those inferred or informally communicated from other shareholder governments:

Commercial Profit

- Meet current year budgeted company net income and profit distribution
- Sustain profit growth (optimize or maximize)
- Maximize return on investment
- Increase enterprise value

Responsible Gaming

- Comply with regulations
- Align with provinces' responsible gaming strategies

Other

- Avoid surprises and bad press
- Foster economic development and job creation
- Be involved in and support the community
- Engage and retain employees
- Reduce the number of VLTs

Recommendation 2.5
Shareholder governments should define formal performance expectations for ALC that are clear and publicly communicated. These performance expectations should be updated annually as part of the shareholder governments' oversight and strategic direction.

Shareholder Response: *Agree. This recommendation will be given consideration in the development and implementation of the process to address the above recommendations.*

Improvements Needed in ALC Performance Reporting

2.48 *Performance reporting* – We reviewed ALC's annual accountability reports, including management discussion and analysis, to assess the quality of its performance reporting. Improvement is needed in ALC's annual performance reports to show progress made towards meeting their commercial and public policy objectives.

2.49 Performance information is not presented in a separate or distinct section of the annual report. Instead, it is scattered throughout the report, making it difficult for users to review and assess. Measures included in the report are not consistently presented with targets and prior year comparatives. There are no measures to demonstrate corporate social responsibility and expected public policy objectives related to player protection and responsible gaming. These are key result areas for the Corporation. Public and internal reporting does not have relevant industry performance benchmarks and comparators. This would help add context to reported results. For example, a comparison of ALC per capita sales data to other jurisdictions, and comparisons of retail outlet density, would help users to interpret ALC performance information.

2.50 Performance reporting to the Board, via the corporate balanced scorecard, does not demonstrate progress towards ALC's growth strategy or how ALC has optimized its profits as stated in its own mandate. For example, it does not have a year-over-year measure of profit growth performance and a target. Through our analysis, we determined the five-year annual average net profit growth rate for the period 2010 to 2015 was negative 1.1%.

Exhibit 2.4

Atlantic Lottery Corporation – Five Year Net Profit and Growth Trend						
Fiscal Year	**2009-10**	**2010-11**	**2011-12**	**2012-13***	**2013-14**	**2014-15**
Net Profit ($ millions)	$389.4	$371.1	$369.7	$361.1	$368.4	$368.2
Year-over-year %		-4.7%	-.04%	-2.3%	2.0%	-0.1%
Average year-over-year %						-1.1%

* *As restated*

Source: Prepared by OAG staff from ALC's audited financial statements

2.51 We used the guidance on management discussion and analysis from the Chartered Professional Accountants of Canada as a best practice guide to evaluate ALC's performance reporting. Recommended practice says the discussion and analysis should identify and define key performance measures and indicators for the company, and explain their significance to strategies and results.

2.52 Public reporting on performance is important for accountability to the owners who are ultimately the public. It is the means by which those charged with stewardship (i.e., the Board) demonstrate to all stakeholders how they have managed the assets entrusted to them.

2.53 Performance information is important to hold ALC accountable to shareholder governments and the public for an important source of government revenue.

Recommendation 2.6

The ALC Board should set performance targets that are measurable indicators of planned outcomes, as well as incorporating relevant industry performance benchmarks. Actual performance against these targets should be publicly reported annually.

Atlantic Lottery Corporation Response: *Agree. With full Board oversight, the Corporation has long operated under a well-defined Balanced Scorecard that has served to provide clear and measurable targets. As of September, 2016, ALC will publicly report against BSC results in its annual report. Earlier this year, the Board directed Management to construct for review an industry benchmarking framework comparing the performance of ALC to industry peers. It is the intent to have benchmarking in place for the 17/18 fiscal year.*

Authority and Decision-making

Conclusion and summary of observations

We found the Board lacks independence from government to carry out its responsibilities in governing ALC. Its scope of authority is not well defined by shareholder governments. We also found the Board does not receive sufficient and timely information from shareholder governments to allow it to fulfill its role of balancing commercial and public policy objectives.

Unclear Board Authority and Owner Intervention Cause Inefficiencies and Higher Costs

2.54 *Decision-making authority* – We found confusion and uncertainty around ALC's decision-making authority. It has not been clearly defined when shareholder government approval is required and who within government has the authority to provide such approval. For example, regarding the offshore investment in Geonomics, a legal opinion sought by ALC, determined approval at the Governor-in-Council (i.e., Cabinet) level in each shareholder government was needed for some of the provinces. Beyond this example the need to obtain shareholder government approval is determined on a case by case basis. This leads to an ineffective and inefficient decision making process.

2.55 The review and approval of the Unanimous Shareholder Agreement (USA) in 2009 was stalled due to uncertainty between shareholder governments on whether amendments could be authorized by the Minister, or whether Cabinet approval was required. As a further indication of the uncertainty experienced by ALC, we noted legal opinions on three separate instances provided to ALC since 2009. The legal opinions were regarding various questions of the business's authority and guidance as to legislative approval steps required in each province.

2.56 An outside study of ALC's governance, commissioned by ALC, found intervening owners (i.e., the four provincial shareholders) to be one of the main factors impacting governance effectiveness. This study noted that *"the Provinces tend to intervene in what would typically be considered arms-length operational decisions"*. This contributes to tension in the governance arrangements and ALC's ability to adapt to changes in the market.

2.57 An example illustrates the decision-making risk to ALC and the impact of not receiving timely information from shareholder governments before funds are committed. At the 2010 annual general meeting, the Board and shareholder representatives approved various internet gaming initiatives as part of the corporate strategy and business plan. The next year, when these projects were nearing completion, shareholder governments informed ALC they would not support these products. This resulted in write-offs of capital expenditures totaling $640,000 because the development costs for iGaming products such as iPoker and iLottery could not be recovered from gaming revenue.

Recommendation 2.7
Within the accountability framework, shareholder governments should clarify which level of government authority (Deputy Minister, Minister, Cabinet or Order in Council) ALC requires to enter into transactions.

Shareholder Response: *Agree. Although roles, responsibilities and authorities exist in each Province, the Shareholders agree that over the next year a formal documented framework should be developed.*

2.58 *Government intervention* – We found accountability relationships and transparency between ALC, the Board, its directors and shareholder governments are not clear and result in direct owner (i.e., government) intervention. During the course of our work, we were informed shareholder governments have directed ALC to make expenditures they may not have otherwise done in their normal course of business.

2.59 For example, ALC was directed to enter into a series of projects with a Nova Scotia VLT supplier (Techlink) that was known by ALC management and the Board to be underperforming. It was within NSPLCC's normal operating authority to direct the activities of ALC as its agent. It is also expected that while NSPLCC owns all gaming assets within Nova Scotia, purchases of such assets are made by ALC.

2.60 In this case, ALC was directed on September 18, 2013 to execute a contract with Techlink by September 25, 2013 and pay, on the same day, a $1.3 million advance to Techlink, representing 90% of the value of the contract. ALC made the payment as directed.

2.61 While we have not conducted a separate performance audit of NSPLCC's operations, this directive was carried out against the recommendations of ALC management and the Board who outlined their concerns to NSPLCC including:

- *"with respect to generating a positive short term return on this expenditure;*
- *the suppliers ability to deliver the projects to completion;*
- *the long term viability of the supplier;*
- *failure to confirm the business case for the investment;*

- *failure to engage in negotiations with the vendor to ensure ALC and the shareholders receive the best value; and*
- *failure to align payment to deliverables."*

2.62 In this case, NSPLCC used its authority to have this payment made to a company that eventually went bankrupt and did not successfully deliver on all of the requirements. All costs related to this were borne by the Nova Scotia Government and the Nova Scotia taxpayers. When Techlink did not meet the requirements of the agreement, Atlantic Lottery cancelled the remaining work and received a refund of approximately $440,000.

Recommendation 2.8
The ALC Board should separately report in the Corporation's annual report any decisions taken by a shareholder government that would otherwise contravene a Board decision or established business practices.

Atlantic Lottery Corporation Response: Agree. ALC will adopt this practice beginning with the 2017/18 annual report. ALC respects Shareholder authority and rights established under provincial gaming legislation.

Board Governance

Conclusion and summary of observations

We found the Board has adopted, and continues to implement, many best practices related to board governance. However, we observed some gaps in the oversight efforts of the ALC Board. We found the Board did not consider priorities and tolerance for risks of individual shareholder governments in making business decisions. As well, the composition of the Board and the appointment process for directors inhibits overall Board effectiveness.

2.63 *Strong Board practices* – We observed the Board of Directors adhering to many best practices in board governance such as:

- Nominating an independent board chair
- Conducting annual board evaluations and member peer assessments
- Making good use of sub-committees, including the audit committee, complete with documented terms of reference and committee charters
- Providing orientation for new members

- Thoroughly and regularly updating and approving the governance manual, complete with terms of reference, charters, and position profiles

2.64 We also noted the Board is continuing to improve and refine its governance processes.

- All directors are encouraged to take training from the Institute of Corporate Directors.
- It was evident from our interviews and surveys that all Board members understand their fiduciary duties and responsibilities to the Corporation.
- Board minutes were descriptive and relevant.
- There are processes for tracking and reporting back to the Board on status of action items and Board resolutions.
- Corporate governance principles and practices of the Board are clearly documented in the Corporate Governance and Board Policy Manual. This manual is regularly updated and approved by the Governance Committee and Board.

2.65 *Board oversight* – We found weaknesses in the Board's oversight work to support its approval to make the $8 million investment in UK-based Geonomics (formerly named Roboreus). Reports to the Board were missing key information on the investment risks. Also, the Board did not fully appreciate the risk tolerance of the shareholder governments as explained below.

2.66 The Geonomics investment involved a start-up UK company that had developed a new online lottery product called GeoSweep. This investment supported multiple aspects of the corporate strategic plan. It provided both exposure to the gaming market outside of Atlantic Canada and potential for new sources of revenue in mobile gaming.

2.67 Management brought the opportunity to the Board's attention on March 2, 2011, followed shortly after (March 15) by a full investment proposal, term sheet and business plan. The risk analysis within the proposal to the Board identified the capital at risk from this investment as low, but the investment proposal included an estimated five-year return on investment of 510 percent. Despite such a high projected return, which could be indicative of a high risk investment, the risk analyses prepared by management did not identify any high risks associated with this investment.

2.68 On April 21, the Board authorized the $8 million investment pending management's completion of its due diligence work and getting legislative authority from at least one shareholder government. It needed at least one government to agree to participate because ALC did not have authority within its mandate for this venture. Each province wanting to participate needed to get appropriate legislative authority from its respective Cabinet.

2.69 On May 11, 2011, the Prince Edward Island Lotteries Commission (Province of Prince Edward Island) obtained the legislative authority for ALC to complete the investment transaction. At that time, Prince Edward Island was the sole participant in the investment venture. Almost a month later, after receiving Governor-in-Council approval, New Brunswick joined and became the second and only other shareholder government to participate. Newfoundland and Labrador rejected the idea the following year. ALC Board minutes indicated NSGC (predecessor to NSPLCC) was in support and that select Ministers were being briefed early in 2012. However, Nova Scotia ultimately did not participate. In 2015, based on the poor previous results and the improbability of any future return, the entire value of the investment was written off. The entire investment loss was absorbed by New Brunswick and Prince Edward Island.

2.70 We identified a number of concerns with how this investment moved forward. Management did not fully disclose all relevant information and risks to the Board. Management presented summarized due diligence findings which did not identify the high risk nature of investing in a technology start-up. In particular, reports did not highlight the lack of revenue and cash flow, the investment's reliance on the success of the game, and its unproven business model. These issues are described in greater detail in the following bullets.

- Reports to the Board did not disclose the numerous commercial and IT risks that had been identified to management such as:
  - reliance on ALC to effectively market the game;
  - untested nature of the game and daily draw structure;
  - lack of compliance with data security standards and manual testing; and
  - commercial and business plan assumptions were considered optimistic.

- Management encouraged the Board to make a quick decision and told Board members the deal might be lost if a decision was not made by the April 30, 2011 deadline. The game developer Roboreus was concerned with how long the deal was taking and had indicated they were in contact with other potential investors. The timeline for the Board's review and decision was less than two months. We found this to be a short period within which to evaluate such a unique transaction for ALC.

- Management did not provide the Board with the full due diligence report, nor did they disclose all of the risks identified in that report to the Board. They also did not report to the Board that due diligence work found that Roboreus would face a cash flow shortage by mid-to-late April 2011.

- The Board and ALC management did not consider the risk tolerance of the shareholder governments and the impact an adverse outcome would have on their reputation and ability to pursue other ventures in the future. The Board did not conduct its own independent due diligence work but rather relied on information and analyses provided by management. From our review of reports and Board minutes, it appears there was a lot of excitement and strong belief in the potential of the company and the game by management, but there was very little hard evidence to support this view. Despite the interest expressed from other jurisdictions, there were no contracts, other than with ALC, to license the game.

2.71 It would appear this initiative was outside ALC's normal scope of operations and outside of its established mandate. The Board should not have approved an initiative that it knew, or ought to have known, was outside of the Corporation's mandate before sufficient approvals were obtained from all shareholders.

2.72 As part of its overall fiduciary duty, the Board needs to arrive at its own decision, independent of management bias and influence. A board of directors must evaluate if it should engage its own independent expert or request additional information and disclosure from management. The Board did ask management to look at additional measures to further mitigate capital at risk. This resulted in a revision to make a portion of the investment as a loan that could later be converted into equity after certain conditions were met. However, this did not help mitigate the $8 million loss to ALC and the participating provincial governments. Within three months, the loan was converted to equity.

2.73 The shortcomings in the Board's work on this investment occurred in 2011, provided many learning points for the corporation, and contributed to the growing maturity of the Board's processes. We found the Board learned from this mistake and better exercised their oversight on subsequent major initiatives, such as the VLT replacement project and updating to a new ERP (Enterprise Resource Planning) system. For example, the Board contracted a consultant to advise them on what issues to raise and questions to pose to management in review of the ERP business plan. Review of minutes and Board action items showed the Board routinely challenged management assumptions and asked management to conduct additional work before approving their proposals.

Recommendation 2.9
When evaluating new or unusual business ventures, the ALC Board should critically evaluate the relevant experience and skill sets on the Board. As needed, the Board should supplement missing skills with contracted, independent, third-party support.

Atlantic Lottery Corporation Response: *Agree. It is now the Boards practice to engage third party, independent advice for major investment decisions to evaluate and mitigate risk and to compensate for specific skill or experience deficiencies.*

Recommendation 2.10
The ALC Board should ensure risks are properly assessed and mitigated to an acceptable level before making investment decisions. It should also ensure that future business venture decisions are aligned with shareholder governments' priorities, policies and tolerance for risk before proceeding.

Atlantic Lottery Corporation Response: *Agree. The Board appreciates the observations and are pleased to report that more robust risk management practices including alignment with Shareholder Governments before making investment decisions are now in place. The Board will continue to ensure risks are properly assessed and mitigated, and will continue to seek third party advice where an independent assessment would enhance decision making.*

Recommendation 2.11
The ALC Board should ensure it obtains sufficient and appropriate information from management to adequately assess the potential risks, rewards, and appropriateness of future proposed initiatives.

Atlantic Lottery Corporation Response: *Agree. The Board is concerned with the observations in the report and will follow up on them. The Board has a high degree of confidence that it receives timely, sufficient, and appropriate information from Management. The Corporation benefits from transparent relations between Management and the Board, where vetting assumptions is the norm.*

2.74 *Board composition and appointment* – We found the Board appointment and nomination process in place during the audit period did not ensure Board independence from the four shareholder governments. Director appointments did not follow an open, competitive process based on competencies and skill sets needed on the Board. Each shareholder government appoints two directors to the Board each year. Four of the eight directors are senior public servants. These same individuals are informally expected to represent and act in the interests of their respective shareholder governments. Furthermore, the year-to-year appointment, or re-appointment of directors, can result in a high turnover of directors which reduces Board effectiveness through loss of corporate knowledge and experience.

2.75 We found the dual role and expectations placed on shareholder representative directors may hinder the effectiveness of governance of the Corporation. The diagram in Appendix IV graphically demonstrates how the Board can be fragmented due to the unilateral relationships between each province, ALC executives, and individual directors that follow jurisdictional lines. It may place directors in a situation in which a good corporate decision may not be a decision they would support as a government representative. Alternatively, decisions they may make at the provincial gaming level could negatively impact on ALC for which they are a director. An example of the ineffectiveness was seen when the Board unanimously approved by-law changes related to changes in director appointment processes, but then the same four Board members, acting as shareholder representatives, did not accept the changes they had just approved.

2.76 Board composition with senior government officials and the lack of clearly-defined levels of authority contributed to the misalignment between ALC's commercial strategy and subsequent government policy and direction. ALC management acted under the presumption that the support at the annual general meeting by these senior government officials constituted shareholder government support, which was not the case. Corporation management believed these members spoke for their shareholder governments.

2.77 We found the informal nature of the role of public servant directors on the Board undermines formal communication channels and increases the risk of information not being provided or being inadvertently modified. Other directors and management may misconstrue what the public servant says to be the views and direction of the shareholder government. However, all shareholders identified the public servant board member as their first point of contact.

2.78 An instance in which this may have occurred related to a Board motion regarding a pension deficit funding plan. This required unanimous approval from shareholder governments. The plan moved forward, requiring $79 million in additional shared contributions to the pension plan. However, there was no formal record of approval from each shareholder government to proceed.

2.79 There is a valuable role for public servants to play in the governance and accountability framework. In a sensitive and regulated area such as gaming, they can serve as a direct liaison with government and a means for conveying government priorities, concerns and sensitivities on key Board decisions. This role must be separate from the statutory decision-making role of corporate director. Everyone should be clear on the purpose of the public servant's role at the Board table. This would alleviate potential conflict created by divided loyalties and allow formal recognition of the role and responsibilities public servants are to fulfill.

2.80 In 2014, ALC's Board recommended a good process to nominate an independent, skills-based board. This was included in the proposed mandate letter at that time. The skills and competencies were based on a skills matrix and a skills gap analysis previously developed by the governance committee and accepted by the Board. Although it was signed by Ministers from three of the shareholder governments, with an agreement to operationalize from the fourth, the board nomination process was not accepted by shareholder governments. Subsequent to our audit period, shareholder governments agreed to increase the size of the Board by four so that there would be three directors from each province. Two directors would be appointed by government, based on competency and skills, and the third would be a senior public servant. This is still not recommended practice in the public sector.

Recommendation 2.12
Shareholder governments should authorize updated governance structures and processes to reflect best practices for the composition and appointment of Directors, including:

- a Board selection process that is competency-based, professional, competitive, open, transparent and reflective of the skill requirements for the Board, and the needs and practices of each shareholder;
- Shareholders appoint voting Board directors for a fixed term greater than one year, subject to renewal; and,
- Board members not be elected officials nor employees of Government.

Shareholder Response: *Agree/Disagree. Shareholders are currently updating processes and governance structures to appoint Board members for ALC. The by-laws have recently been updated to allow Shareholders to nominate up to two independent directors who are not government employees or elected officials and up to one non-independent director. These directors will serve staggered terms of three years.*

Given the depth and breadth of the recommendations in this report the Shareholders believe that it is in their best interests to continue to have a government representative at the board.

Recommendation 2.13
Shareholder governments should change the role of public servants (i.e., government shareholder representatives) on the ALC Board to be non-voting, ex officio members in accordance with best practice.

Shareholder Response: *Disagree. See response to 2.12. The Shareholders may be willing to revisit this recommendation once the work on the other recommendations in regard to governance has been completed, any resulting changes implemented, and the effectiveness of those changes monitored and evaluated.*