Crown Corporation Governance in the Government of Canada

The 2005 Review and Beyond

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Context: Crown Corporations in the Government of Canada

Within Canada's system of government, the Crown corporation is one of the oldest forms of public sector organization outside of the ministerial department, dating back over a century. It is also one of the most widely used: the federal public administration currently includes 47 parent Crown corporations, and subsidiaries that report as parents, which collectively employ some 87,000 full-time equivalent staff.[1]

As such, the "Crown" is one of Canada's important forms of "distributed governance", a term that PGEx uses to describe the devolution of executive responsibilities and authorities to organizations beyond direct day-to-day ministerial control. Measured in terms of expenditure, distributed governance now accounts for a majority of government activity – some 55% at the federal level and averaging nearly 80% among provincial governments.[2]

Historically there have been two overarching motivations for distributed governance. One has been to limit day-to-day ministerial decision making with respect to the organization's substantive responsibilities in order to preserve their integrity – for example, in the case of organizations that oversee government activity, make quasi-judicial decisions, exercise specialized technical expertise or have a distinctive vulnerability to political influence (such as public broadcasting).

The second major motivation for distributing governance has been to remove certain activities from the broad range of operational controls that apply to government organizations. The intent in such cases is to give operational organizations, particularly those with a commercial orientation, the capacity to respond efficiently to service development requirements and the demands of the marketplace. That said, distributed governance organizations are never expected to operate entirely outside of the system of "public sector values" (e.g., transparency, accountability, frugality) that drive government operational rules.

While PGEx research[3] has confirmed a close relationship between organizational form and organizational function in most Canadian public sector entities, the Crown corporation organizational model has been used for an exceptionally diverse range of functions – commercial, cultural, regulatory and advisory – and includes both appropriation-dependent and self-sufficient or dividend paying entities. However, it is exceptional for distributed governance organizations to be given policy-making

[1] "Consolidated Statement of Employment and Financial Position", Treasury Board of Canada Secretariat, <http://www.tbs-sct.gc.ca/reports-rapports/cc-se/crown-etat/fintab1-eng.asp>, retrieved December 7, 2012.
[2] See *Distributed Governance Organizations: Quantitative Analysis of the Canadian Public Sector*, IOG, 2012.
[3] Developed in the Governance Continuum. See *The Governance Continuum: Origins and Conceptual Construct*, IOG, 2012. Under the taxonomy of this analytical model, Crown's would be classified as operational service organizations.

authorities, which Ministers tend to reserve to themselves, and a corporation is not an obvious vehicle for policy responsibilities. That said, there are notable exceptions, such as the monetary policy role of the Bank of Canada.

But while Crowns seldom make public policy, they are important instruments of public policy. Wholly owned by the government, they discharge statutory mandates for which Ministers are ultimately accountable. This is a fundamental distinction from private sector corporations and has profound implications for even the most commercially oriented of Crowns.

The majority of federal Crown corporations are subject to the governance regime set out in Part X of the *Financial Administration Act*, which has been in place since 1984. A small number of these companies ("Schedule III, Part II corporations", which generally operate in a competitive environment and are not appropriation dependent but rather earn a return on equity and have a reasonable expectation of paying dividends) have slightly elevated autonomy – for example, they are not required to submit an annual operating budget (although they must still submit a corporate plan and capital budget). However, their corporate plan must include a dividend proposal.

A minority of Crowns are exempt from most Part X requirements to preserve their need for greater autonomy and are governed instead by their constituent acts. While these governance regimes often resemble that of Part X, they are not required to submit corporate plans for approval of the Governor in Council and they are not required to submit for tabling in Parliament summaries of corporate plans, capital budgets, or operating budgets.[4] Further, in setting out their mandates, these acts may endow the corporation with distinctive powers, duties and functions.

The 2005 Review

The 2005 review of federal Crown governance practices was one of several major management and accountability reviews undertaken at the time by the President of the Treasury Board for report to Parliament, and was the first comprehensive review of the Crown governance framework since the FAA Part X regime was enacted in 1984. As suggested by its subtitle, *Meeting the Expectations of Canadians*, it was undertaken with explicit regard to increased public scrutiny. This was in the wake of a series of corporate scandals, including Enron and WorldCom, that had shaken market confidence and led to more rigorous governance standards for publicly traded companies (for example, with respect to audit and the role of Boards), the US *Sarbanes-Oxley Act* being the best known. Further, a February 2005 report by the

[4] Crown Corporations' Tabling Information, Treasury Board of Canada Secretariat, <http://www.tbs-sct.gc.ca/reports-rapports/cc-se/crown-etat/info-eng.asp#ftn3>, retrieved December 7, 2012.

Auditor General on the governance of Crown corporations had identified, among other criticisms, a lack of clarity around key principles and accountability relationships.

In conducting the review, TBS consulted broadly, including with numerous Crown Chairs and CEOs, deputy ministers of portfolio departments, and senior-level roundtables on corporate governance. These consultations disclosed divergent opinions among the senior officials responsible for these organizations regarding certain fundamentals of Crown governance, including the nature of their autonomy and the reporting and accountability relationships among CEOs, Boards, ministers and Parliament. This tended to corroborate the position of the AG that increased clarity around these basic principles was needed.

The Report to Parliament that emerged from the review included **six main findings** – that is, six broad areas where changes were needed:

- Reasserting the role of Crown corporations as instruments of public policy;
- Clarifying and strengthening the accountability regimes for Crowns and the stewardship roles of Directors;
- Ensuring that the appointment processes for Crown CEOs, Chairs and Directors reflect appropriate governance standards;
- Better equipping Boards to fulfill their responsibilities;
- Ensuring that Crown governance keeps pace with best practices, including private sector reforms as applicable; and
- Increasing the transparency of Crown activities and operations.

These findings translated into 31 "measures". As the Report was issued under the auspices of the TB President, the measures were more in the nature of government policy than recommendations. A list of the 31 measures is found at Annex A.

The thrust of the **first finding** was that, however diverse the functions of Crowns and however extensive a given Crown's level of autonomy, **every Crown exists to further a public policy purpose** for which a Minister is ultimately responsible to Parliament, and this implied the legitimacy of Ministers setting broad directional expectations for Crowns. The corresponding measure – described as an instrument of "active ownership" – was that responsible Ministers would issue a "statement of priorities and accountabilities" to Crowns (since re-cast as letters of expectation / statement of priorities). These would respect the legal autonomy of the corporation and not seek to interfere in day-to-day operational matters, nor would they be "legally binding". As the concept evolved, it was seen as being incorporated systematically into the corporate

planning and approval process – the clearest area of ongoing ministerial engagement in the activities of the Crown and one whose use as an instrument of government direction was perceived as being very uneven.

The **second finding** was closely related to the first: in committing to “clarify” accountability relationships, the Report indicated that **Crowns are accountable to Ministers and Ministers to Parliament**, putting paid to the idea of a direct accountability relationship between Crowns and Parliament. Among other recommended changes to the FAA, the famously cryptic section 88, stating that Crowns are accountable to Parliament *through the appropriate Minister*, would be amended for greater clarity. The Report stated the Minister effectively exercises the role of owner on behalf of the government, noting that the concept of shareholder was not readily transferable to a public sector context, regardless of whether the corporation had formal share capital.

The report also stated rather starkly that “the CEO is accountable to the Board of Directors for the management and performance of the corporation”. This statement, making no reference to the Minister, was arguably hard to reconcile with the fact that most Chairs are appointed by the GiC rather than the Board.

The emphasis on CEO accountability to the Board influenced the **third finding**, regarding the need for **a more rigorous appointment process**, one of the related measures being that “the selection process for the CEO will be determined by the Board of Directors”. The Report also recommended that the government work with parliamentary committees “to ensure a workable appointment review process that will not unduly delay necessary appointments”. Other recommendations in this area – published selection criteria, creation of a central website, improved due diligence on references and conflicts of interest – did not impact on the basic appointment authority in the same way.

Many of the recommendations flowing from the **fourth finding**, that **Boards should be better equipped to discharge their responsibilities**, and the **fifth finding**, that it was necessary to **keep pace with best practices**, were clearly influenced by emerging private sector practices.

With respect to **Board composition**, for example, the Report was clearly influenced by the trend toward “independent” Boards (that is, independent of senior company management). The Report committed the government to reviewing the appointment of public servants to Boards “with a view to restricting or eliminating their participation”, splitting the positions of CEO and Chair, and requiring that the CEO be the sole representative of management to the Board. The exclusion of public servants from Boards was an area in which government was later to revisit the thinking that underlay the Report.

Another major point of emphasis was the Board's **audit committee**. Independent, financially literate committees chaired by individuals with financial expertise were to become mandatory, and both internal and external auditors were to report to the committee. These measures were consistent with private sector developments at the time, as were proposals for mandatory Board charters, certification by directors, and improved orientation, professional development and performance evaluation for directors.

With respect to **external audit** and special **examinations**, the mandate and authority of the Auditor General were to be expanded. Specifically, legislative amendments would allow for the appointment of the Auditor General as external auditor or joint auditor for all Crowns, and to authorize the Auditor General to conduct special examinations of all Crowns, with increased discretion as to timing. Subject to protocols to protect commercial interests, special examinations would be submitted to Parliament.

Under the **sixth finding**, on the **need to increase the transparency** of Crown activities, the key measure was the proposed extension of the *Access to Information Act* to 10 of the 18 Crowns that were still outside the regime, with a view to adding seven of the eight others once improved mechanisms for protecting their commercially sensitive information were developed. (The CPP Investment Board could only be added with provincial consent.) Other measures included enhancing the clarity around Crown appropriations in the Main Estimates. The Report also noted that Crowns were included in the draft *Public Servants Disclosure Protection Act* (the so-called whistleblower legislation), including its provisions for a Code of Conduct for the federal public sector (and not simply the core public administration) and individual organizational codes.

Implementation of the Measures

In the years since the Report, and notwithstanding the change in government shortly after it was issued, the large majority of its measures have been implemented in at least some form. The Treasury Board Secretariat led on most of the measures, although in the case of appointment and accountability related measures responsibility lay with the Privy Council Office. Some measures, such as the adoption of Board charters and aspects of audit committee composition and practice, were implemented by the corporations themselves.

A number of measures were implemented soon after the Report, including instances where Orders in Council or even legislation was required. For example, 10 Crowns were brought within the ATI regime by OIC in 2005, and in the 2005 *Budget Implementation Act* provided authority for the Auditor General to serve as external auditor and conduct special examinations for all Crowns. A number of measures were

addressed through the *Federal Accountability Act* (2006), including several pertaining to audit committees and Board appointments. Other legislative changes, some of them comparatively narrow and even technical in nature, waited until the *2009 Budget Implementation Act* – for example, measures pertaining to annual public meetings, the indemnification of directors, and the timing and release of special examinations, as well as the requirement that the CEO be the sole representative of management on the Board.

For the majority of the measures, implementation was a matter of government practice. This was the case with the appointment process changes, all of which have since been implemented (although in one significant instance, discussed below, the implementation has since been reversed). Clarification of accountability relationships was achieved through the development of appropriate guidance, including through established vehicles such as *Accountable Government: A Guide for Ministers and Ministers of State*. Guidance materials have also been used in other areas, such as the conduct of annual public meetings.

The implementation of at least one important measure was dependent directly on the responsible Ministers – namely the use of statements of priorities.[5] Portfolio coordination practices, of which these statements can be seen as an example, are the purview of the responsible Minister and also depend on the composition of the portfolio. Hence they tend to vary significantly across portfolios. Not all Ministers have chosen to issue these statements to Crowns for which they are responsible, and even where they are issued their contribution to the corporate planning practice has reportedly varied. This is not to say that a more systematic approach is impossible. For example, if he so chose, the Prime Minister could indicate to Ministers in their mandate letters that expected consistent use of this instrument.

Non-Implemented Measures and Evolving Areas

Perhaps the most direct retreat from the Report's measures (although not necessarily viewed publicly as such) concerned parliamentary review of non-judicial Governor-in-Council appointments. While the government may be considered to have begun implementing this measure, following the rejection of its candidate for the first head of the Public Appointments Commission (a Federal Accountability Implementation Plan commitment) in 2007 the government ceased to make use of this practice and no longer supports it.

Also, as noted above, the government relied on guidance instruments to clarify its position on accountability relationships for Crown corporations and did not amend

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[5] TBS has posted an issue note on Letters of Expectation / Statement of Priorities at <http://www.tbs-sct.gc.ca/gov-gouv/tools-outils/cc-notes-se/mle-lmca-eng.asp>

section 88 of the *Financial Administration Act*. It is true that successive governments have been hesitant to re-open the FAA in a minority Parliament, but given the broad swath of changes under the *Federal Accountability Act* and successive budget implementation acts, this can hardly have been a significant factor in the decision not to amend in this area. A more likely explanation is that, on reflection, the formulation set out in section 88 was judged to be about as precise as one could reasonably expect, and the search for new wording was likely to prove contentious and unproductive.

One area in which the government subsequently wrestled with and effectively retreated to some extent from the thinking in the Report was the appointment of public servants as Directors. The Report acknowledged that there would need to be a limited number of cases in which public servants continued to serve on Boards "when it is essential to the best interests of the government and the Crown corporation" but the threshold for the practice was clearly intended to be very high. Subsequent to the Report, public service membership was adjusted for a number of Boards, but in most cases this was not done.[6] Generally, as was the case at the time of the Report, public servants are included ex officio on Boards in only in exceptional circumstances where they provide distinctive expertise or, as in the case of several large financial Crowns, where the government has significant financial exposure.

What is interesting about this area is less the specific number of public servants on Boards – which was and continues to be small – than particular aspects of the underlying thinking. The Report was explicitly concerned with possible risk to the independence of the Board – it's ability to perform what was called a "challenge function" vis-à-vis the government (referring presumably to the fiduciary responsibilities of Directors). It was also concerned that public servant Directors might be in a position of conflict between their fiduciary obligations and their duties to their Minister (although the legal concept of conflict of interest was avoided). There was also some concern that a DM on a Board might simply wield disproportionate influence.

The government's position – and the guidance it has provided to public service Directors – has been that there is neither a formal conflict of interest nor a practical problem with ex officio Board membership. In the first place, since DM-level directorships are provided for in statute, their participation is clearly part of how the regimes in question were intended to work at law – that is, it was intended that the perspective of the department and Minister be brought to bear on the deliberations of the Board. Further, it is not a violation of the public service Director's fiduciary responsibilities to bring a public service perspective to the Board, but rather is an

[6] Public servants, mainly at the Deputy Minister level but in some cases at the ADM level, continue to sit ex officio on five Crown corporation Boards, mostly under statutory authority: The Bank of Canada (DM Finance), Canada Deposit Insurance Corporation (DM Finance), Canada Mortgage and Housing Corporation (DMs Finance and HRSDC), Canadian Tourism Commission (DM Industry) and Canadian Commercial Corporation (ADM Materiel, DND).

appropriate part of the mix of perspectives that Directors of various backgrounds bring to the Board. The fiduciary responsibilities of directors must be understood in terms of the organizational mandate, which in the case of public sector bodies always include a public policy dimension. At the same time, the government has acknowledged that the public service Director is not an instrument of government direction to the Crown, and that his or her positions carry the same weight as those of any other Director.

To some extent, this issue may be viewed as part of a larger challenge that the government appears to have wrestled with regarding Crowns – specifically, how to ensure that, consistent with their legislative independence, their activities could be brought into alignment with the broader government agenda. In this connection, it is worth noting that since 2006 the government has issued directives to Crowns on nine occasions, which outstripped the use of this instrument through the two preceding decades that followed the enactment of the Part X regime.

Issues for Discussion

- Have the reforms that followed the 2005 Report improved the quality of federal Crown corporation governance? What is working and what isn't? Are further changes needed?

- Are there additional areas where private sector governance practices should applied to public sector corporations? Where they shouldn't?

- Are the accountability relationships between Crown corporations and other government actors clear?

- Do the activities of Crowns need to be better aligned with the broader government agenda? Could more effective use be made of the Statement of Priorities (or of the corporate planning process) in this regard?

- Has the increased use of directive powers in recent years threatened Crown independence? Has affected the way Crowns operate?

- How does the public policy mandate of a Crown corporation impact on a Director's fiduciary responsibilities?

- Are private sector appointees to Crowns sufficiently sensitive to public sector values?

- Should public servants to be appointed to Boards?

- Should the Board of Directors appoint the CEO?

Annex A: Summary of measures from *Meeting the Expectations of Canadians*

Measure #1
The government will clarify the accountability structure for Crown corporations, including in the FAA, in order to describe the relationships between Parliament, the responsible Minister, the Board of Directors and the CEO.

Measure #2
The government will affirm, including through amendments to the FAA and other relevant statutes, that the responsible Minister is its representative.

Measure #3
To improve the communication of policy objectives and priorities from the government to Crown corporations, the responsible Minister will issue a statement of priorities and accountabilities to Crown corporations within his or her portfolio. The statement will be discussed beforehand with corporate management and the Board, but ultimately it will reflect the government's policy expectations for the corporation. The statement will be subject to an annual review and help form the basis for a periodic review of the corporation's performance.

Measure #4
In order to reaffirm that Boards of Directors are accountable for the activities and performance of the corporation to the responsible Minister, the government will embody the role and the responsibilities of directors in Part X of the FAA and in other enabling statutes.

Measure #5
The government will review the appointment of public servants as directors on the Boards of Crown corporations with a view to restricting or eliminating their participation. The government will take administrative action, and where necessary seek legislative changes, to implement this measure.

Measure #6
The government will enact the legislative changes required to ensure a split in the positions of CEO and chair of the Board for Crown corporations.

Measure #7
The government will require that the CEO be the sole representative of management to a Board of Directors.

Measure #8
To ensure that the Board may deliberate freely, and exercise the challenge function expected of directors, Board proceedings should remain confidential. The government will require that Boards of Directors of Crown corporations hold annual public meetings at which stakeholders could express their views and seek information about the activities of corporations. Corporations are also encouraged to develop outreach activities to solicit input and feedback from stakeholders on an ongoing basis.

Measure #9
To assist the work of Board members, the government will issue to every new director, upon appointment, a guidance letter that would make explicit the expectations of the government with regard to the role and responsibilities of directors under law and in practice. The letter would also include provisions related to the values and ethics of public office holders and disclosure of conflict of interest.

Measure #10
To strengthen the corporate governance of Crown corporations, the government will work with Boards to adopt a chart that would define clearly the roles and responsibilities of the Board.

Measure #11
To further enhance the skills and performance of Boards of Directors and building on current orientation programs, the Canada School of Public Service will establish additional training and professional development programs on public sector management and Crown corporations.

Measure #12
Consistent with good governance practices, the government will ask Board of Directors to establish regular assessments of their effectiveness and the contribution of individual directors as a self-development tool. The assessment of the Board as a whole will be communicated by the Chair of the Board to the appropriate Minister.

Measure #13
The government will require that Boards of Directors for all Crown corporations establish an audit committee.

- The committee would consist of a minimum of three members and would have the authority to engage independent counsel and expertise, as it deems necessary, to carry out its duties.
- The mandate of the committee should include the requirement to set up a process to investigate complaints related to issues of integrity and behaviour and to establish a risk assessment and management mechanisms as well as adequate controls and protocols to mitigate those risks.

- The audit committee would also adopt an audit plan that would be communicated to the Board of Directors.

Measure #14
All directors on the audit committee must be independent of management and have financial literacy. An individual with financial expertise must chair the activities of the committee. The government will be mindful of this requirement in the context of the selection and appointment process of directors.

Measure #15
In order to enhance and protect the independence of the audit function, internal and external auditors will report directly to the audit committee.

Measure #16
Selection criteria for chairs and Board profiles will be made public by the government. Similarly, Crown corporations will make CEO selection criteria available to the public.

Measure #17
The government will develop a central Web site to solicit potential candidates for director and chair positions.

Measure #18
The selection process for the CEO will be determined by the Board of Directors and will include at minimum, advertising in either or both the *Canada Gazette* and the corporation's Web site.

Measure #19
The government will obtain references on all candidates for appointment as director or chair. In the case of CEOs, the Board's nominating committee will be required to do the same for any candidate it submits to the government for appointment. In addition, the government will continue to conduct background checks and ensure that candidates are not in a conflict of interest, prior to making any appointment.

Measure #20
The government will work closely with parliamentary committees to ensure a workable appointment review process that will not unduly delay necessary appointments.

Measure #21
The government will amend the FAA and enabling statutes to provide for appointments for up to four years.

Measure #22
To respond to the public interest in non-financial issues, the Treasury Board of Canada Secretariat will produce a guidance document for Crown corporations on annual report specifications, including the Management's Discussion and Analysis Section and issues pertaining to values and ethics.

Measure #23
In order to make the financing of Crown corporations more transparent, the government will also ensure that the Main Estimates document clearly indentifies the funds allocated to each Crown corporation that receives parliamentary appropriations.

Measure #24
In principle, the government supports the use of a certification regime adapted to the reality of public institutions. The Treasury Board of Canada Secretariat will examine, in consultation with Crown corporations, the development of a certification regime that would be applicable to all Crown corporations.

Measure #25
The *Access to Information Act* should

- be extended to 10 of the existing 18 Crown corporations currently outside the provisions of the Act by an Order in Council;
- not include seven Crown corporations until the government has developed mechanisms to protect their commercially sensitive information;
- not include the Canada Pension Plan Investment Board at this time because of its federal-provincial structure. Its inclusion will require provincial consent;
- be amended to include protection for journalistic sources.

Measure #26
The government will amend the relevant legislation in order to allow for the appointment of the Auditor General of Canada as the external auditor or joint auditor for all Crown corporations, inside or outside the purview of Part X, Divisions I through IV, of the FAA. In recognition of the specific needs of commercial Crown corporations, and in line with current practice with regard to several organizations, the government would encourage the Auditor General of Canada to work in partnership with private sector auditing firms.

Measure #27
The government will implement the necessary legislative changes to provide the Office of the Auditor General of Canada with the authority to conduct special examinations in all Crown corporations.

Measure #28
The government will establish a more flexible system for the timing of special examinations, reflective of the level of risk related to each corporation. The risk analysis would be based on the complexity of the organization, the field of operation, and the changes taking place in the business and policy environment that may impact on the corporation. The Office of the Auditor General of Canada would have the responsibility for determining the frequency of special examinations for each Crown Corporation. At a minimum, all corporations would undergo a special examination every eight years.

Measure #29
The government will require that each special examination report prepared by the Auditor General be submitted to the Board of Directors, the responsible Minister, the Treasury Board, and Parliament, to maximize the value of these reports to Canadians. In accordance with the provisions of the FAA to protect commercial interests of a parent Crown corporation or a wholly-owned subsidiary of a parent Crown corporation, the government will work with the Office of the Auditor General of Canada to develop a protocol relating to the release of the special examination.

Measure #30
The government will ask the Advisory Committee on Senior Level Retention and Compensation to review the compensation provided to chairs and directors of Crown corporations.

Measure #31
The government intends to develop regulations pursuant to the FAA to provide for an advance of costs to directors in much the same manner as in the *Canada Business Corporation Act.*