

# Joint Audit of Atlantic Lottery Corporation

**October 2016**





October 3, 2016

Dear Sirs:

We have the honour to submit herewith our Report to our respective House of Assembly or Legislative Assembly.

- As required under Section 15(1) of the New Brunswick Auditor General Act
- As required under Section 18(2) of the Nova Scotia Auditor General Act, to be laid before the House in accordance with Section 18(4) of the Nova Scotia Auditor General Act
- In accordance with the Audit Act of Prince Edward Island
- In accordance with the Auditor General Act of Newfoundland and Labrador

Respectfully,

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# Introduction

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# 1 Introduction

- 1.1 The Offices of the Auditors General of New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island commenced a performance audit of the Atlantic Lottery Corporation (ALC) in the fall of 2015. This was the first time since 1996 the Corporation was audited by a provincial auditor general.
- 1.2 For over 40 years ALC has been an example of the four Atlantic provinces working together. Similarly, completion of this performance audit required significant coordination and cooperation between the Auditors General, senior management, and staff of our four offices. Staff members from each Office were involved in conducting the audit. This report is organized into three chapters and discusses our observations, conclusions and recommendations in the following key areas:
  - Corporate Governance;
  - Executive and Employee Compensation and Benefits;
  - Travel, Hospitality, and Board Expenses;
  - Contract Management; and
  - Procurement of Services.
- 1.3 Chapter 2 provides our observations and recommendations relating to the governance of ALC, including the involvement of the four government shareholders, their representatives, and the Board of Directors of the Corporation. The Auditor General of Newfoundland and Labrador did not participate in the governance section of the audit.
- 1.4 Chapter 3 covers areas primarily under the control of management (typically subject to oversight by the Board of Directors of the Corporation), including executive and employee compensation and benefits; travel, hospitality and board expenses; contract management; and procurement of services. All four Auditor General Offices participated in this part of the audit.
- 1.5 The audit found that ALC's governance framework is insufficient to deal with its strategic challenges. All shareholder governments have not provided ALC with clear direction as to their performance expectations for the Corporation, nor have they clearly established the parameters within which the board of directors and management may make autonomous decisions. Further, the governments have not clearly defined the roles and responsibilities of governments, responsible ministers who oversee ALC, and shareholder representatives.



- 1.6 This has made it much more difficult for ALC to address its strategic challenges. For example, pursuing new opportunities for revenue growth within the current governance framework has been difficult and inefficient, even in cases where tacit government approval of initiatives may have been thought to exist. The \$640,000 internet gaming initiative discussed in this report provides an example of the cost of this uncertainty.
- 1.7 Providing clear performance expectations and operating parameters to the board and management of ALC may also address some of the other problem areas we observed during our audit of the Corporation. For example, increases in executive compensation were made without shareholder consultation and have been significant. Also, in some cases, stakeholder relations, board and staff expenditures lacked due regard for economy. These expenditures may or may not have been acceptable to the four shareholder governments.
- 1.8 Improvements to the governance framework are necessary for ALC to:
- function effectively and efficiently in maximizing shareholder governments' returns in an increasingly competitive and constantly evolving gaming market; and
  - ensure ALC knows and respects the operating limits placed on it by the shareholder governments.
- 1.9 It is our hope that this report will encourage necessary changes to ALC's governance framework and operating practices. The implementation of recommendations contained in this report should provide significant improvement in this regard. The four shareholders and ALC have agreed with most of our recommendations.
- 1.10 Finally, we would like to express our appreciation to the four shareholder governments and their representatives, and the board of directors and management of ALC for their excellent cooperation and assistance throughout our work.

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## 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   |
|--|---|
| <p><b>Eight recommendations to the four shareholder governments</b><br/> <b>Note: Recommendation numbers below refer to the recommendation number in the body of the report and therefore may not be sequential.</b></p>   |   |
| <p><b>Recommendation 2.1</b><br/>                     The shareholder governments should complete an in-depth 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.</p> | <p><i>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.</i></p> |
| <p><b>Recommendation 2.2</b><br/>                     Shareholder governments should periodically review the Unanimous Shareholder Agreement and Corporate By-Laws and revise as warranted.</p>  | <p><i>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.</i></p> <p><i>The by-laws were updated by the shareholders and approved by the ALC Board in 2016.</i></p> <p><i>The Shareholders are currently working to update the USA.</i></p>  |
| <p><b>Recommendation 2.3</b><br/>                     Shareholder governments should routinely collaborate and give ALC regular and timely policy direction for ALC to use in its strategic and business planning process.</p>   | <p><i>Agree. The shareholders agree with this recommendation and over the next year, will discuss means to achieve it.</i></p>  |
| <p><b>Recommendation 2.4</b><br/>                     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.</p>   | <p><i>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.</i></p>   |
| <p><b>Recommendation 2.5</b><br/>                     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.</p>   | <p><i>Agree. This recommendation will be given consideration in the development and implementation of the process to address the above recommendations.</i></p>   |

| Recommendations at a Glance   | Shareholder Responses   |
|---|---|
| <p><b>Recommendation 2.7</b><br/>                     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.</p>   | <p><i>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.</i></p>   |
| <p><b>Recommendation 2.12</b><br/>                     Shareholder governments should authorize updated governance structures and processes to reflect best practices for the composition and appointment of Directors, including:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• Shareholders appoint voting Board directors for a fixed term greater than one year, subject to renewal; and,</li> <li>• Board members should not be elected officials nor employees of Government.</li> </ul> | <p><i>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.</i></p> <p><i>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.</i></p> |
| <p><b>Recommendation 2.13</b><br/>                     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.</p>   | <p><i>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.</i></p>  |

| Recommendations at a Glance  | Board of Directors Response  |
|--|--|
| <b>Five Recommendations to Atlantic Lottery's Board of Directors</b>   |  |
| <p><b>Recommendation 2.6</b><br/>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.</p>  | <p><i>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.</i></p> |
| <p><b>Recommendation 2.8</b><br/>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.</p>   | <p><i>Agree. ALC will adopt this practice beginning with the 2017/18 annual report. ALC respects Shareholder authority and rights established under provincial gaming legislation.</i></p>   |
| <p><b>Recommendation 2.9</b><br/>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.</p>  | <p><i>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.</i></p>   |
| <p><b>Recommendation 2.10</b><br/>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.</p> | <p><i>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.</i></p>  |
| <p><b>Recommendation 2.11</b><br/>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.</p>   | <p><i>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.</i></p>   |

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## 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      |
| <b>Profit per shareholder</b>            |              |              |              |              |              |
| 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         |
| <b>Total Profit</b>                      | <b>\$371</b> | <b>\$370</b> | <b>\$361</b> | <b>\$368</b> | <b>\$368</b> |

- 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          |
| <b>Assets</b>  |                  |                  |                  |                  |                  |
| Capital asset  | \$103,525        | \$61,047         | \$126,484        | \$122,094        | \$108,024        |
| Other  | \$74,697         | \$115,823        | \$131,917        | \$128,844        | \$121,773        |
| <b>Total assets</b>                                      | <b>\$178,222</b> | <b>\$176,870</b> | <b>\$258,401</b> | <b>\$250,938</b> | <b>\$229,797</b> |
| <b>Liabilities</b>                                       |                  |                  |                  |                  |                  |
| 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         |
| <b>Total liabilities</b>                                 | <b>\$179,573</b> | <b>\$223,662</b> | <b>\$323,572</b> | <b>\$284,842</b> | <b>\$265,987</b> |

**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.

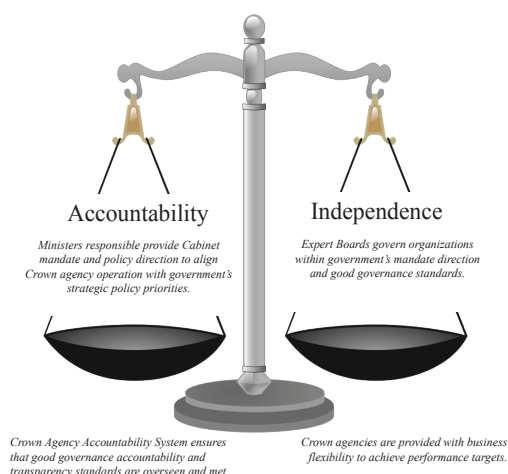
## Audit Conclusion

- 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.

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**Significant Audit Observations****Shareholder Government Oversight and Control**

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## 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.

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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*”<sup>1</sup>. 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:

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<sup>1</sup> *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

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### 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.

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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**

| <b>Atlantic Lottery Corporation – Five Year Net Profit and Growth Trend</b> |                |                |                |                 |                |                |
|---|----------------|----------------|----------------|-----------------|----------------|----------------|
| <b>Fiscal Year</b>  | <b>2009-10</b> | <b>2010-11</b> | <b>2011-12</b> | <b>2012-13*</b> | <b>2013-14</b> | <b>2014-15</b> |
| 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.*

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## Authority and Decision-making

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### 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.

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### 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**

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### 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.*

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## Chapter 3: Non-Governance

### Why we did this audit:

- ALC is owned by the governments of the Atlantic Provinces
- ALC last audited by provincial Auditors General in 1996
- The Corporation returned approximately \$368 million in profit to the Atlantic Provinces in 2014-15
- Atlantic Lottery provides significant revenue to the Atlantic Provinces and has been facing increased competition

### Overall conclusions:

- Compensation administered according to corporate policies
- Significant pay increases for executives without consulting shareholder governments
- Travel, hospitality, and board expenses not well-managed
- Contracts appropriately managed, but the process needs to be documented
- Purchase of services is working well, but some improvements needed

### What we found in our audit:

#### What worked well

- Salaries and bonuses paid according to ALC policies
- ALC has a travel and expense policy
- Contracts have terms to protect ALC and are regularly monitored
- Purchasing of services meets ALC's policies

#### Weaknesses we noted

- Significant increases to executive compensation without shareholder consultation
- Maximum available compensation for the COO and CFO increased by 56 percent
- Overcontributions to pension plan
- Lack of public disclosure of salaries
- Some travel, hospitality and board expenses not properly approved or supported by appropriate documentation
- Spending on concert tickets for elected, political, and government officials
- \$111,000 spent on Christmas events over 29-month audit period not in line with shareholder government practices
- Contract monitoring process not documented
- \$1 million invoice not properly approved
- Supplier conflict of interest disclosures not obtained



| Recommendation at a Glance  | Board of Directors Response   |
|---|---|
| <b>Two recommendations to Atlantic Lottery's Board of Directors</b>   |   |
| <p><b>Recommendation 3.1</b><br/>Atlantic Lottery's Board of Directors should get direction from the four shareholder governments on the Corporation's approach to its compensation packages, including salaries, bonuses, pensions, and other benefits, to determine if it is aligned with shareholder expectations.</p> | <p><i>Agree. The Board will continue to fulfill its governance responsibility in this area. It will seek input and counsel from Shareholders annually and ensure that they are appropriately informed. The Board will ensure that compensation reflects economic and market conditions. It will rely on expert, external advice based on appropriate comparator groups and will also continue to employ a rigorous performance management system as part of the science supporting ALC's total rewards program.</i></p> |
| <p><b>Recommendation 3.7</b><br/>Atlantic Lottery Board should set policies on spending related to Christmas events and the employee recognition program that are in line with shareholder governments' expectations.</p>   | <p><i>Agree. Atlantic Lottery believes that strong morale and a highly motivated staff are an important part of its success. That said, it fully understands that this is a time of economic restraint in Atlantic Canada. As such, effective immediately, we will do the following:</i></p> <ol style="list-style-type: none"> <li><i>1. Eliminate ALC supported holiday events.</i></li> <li><i>2. Establish formal protocols for employee performance recognition by December, 2016.</i></li> </ol>                  |

| Recommendation at a Glance   | Shareholder Response   |
|--|--|
| <b>One recommendation to the four shareholder governments</b>  |  |
| <p><b>Recommendation 3.2</b><br/>The shareholder governments should complete the ongoing review of the Council of Atlantic Premiers pension plan and implement required changes.</p> | <p><i>Agree. The shareholders agree that the pension review that was initiated in January 2016 will be completed. The review will examine the governance, administration and sustainability of the pension plan.</i></p> |

| Recommendations at a Glance  | Atlantic Lottery Corporation Responses   |
|--|--|
| <b>Nine recommendations to Atlantic Lottery Corporation</b>  |  |
| <p><b>Recommendation 3.3</b><br/>Atlantic Lottery should establish a process to ensure required changes to its payroll system are made. The process should include communicating changes to the required staff and confirmation that changes are made.</p> | <p><i>Agree. Effective immediately, ALC will establish a process to ensure required changes are made to its payroll system. It will include communicating changes to the required staff and confirmation that changes have been made.</i></p>        |
| <p><b>Recommendation 3.4</b><br/>Atlantic Lottery should publicly disclose compensation information to promote accountability and transparency. Atlantic Lottery should consult shareholder governments on their expectations for this disclosure.</p>     | <p><i>Agree. As of August, 2016, ALC is disclosing full compensation details for its Executive Team, as well as the names and positions of all employees earning in excess of \$100,000. This will be updated annually and posted at alc.ca.</i></p> |

| Recommendations at a Glance   | Atlantic Lottery Corporation Responses   |
|---|--|
| <p><b>Recommendation 3.5</b><br/>Atlantic Lottery should revise its travel and expense policy to:</p> <ul style="list-style-type: none"> <li>- address whether alcohol is an acceptable expense;</li> <li>- require meeting and entertainment expenses to be preapproved; and</li> <li>- address appropriate approvals for Board member and CEO expenses.</li> </ul> <p>Expenses should only be reimbursed if an adequate description is provided, the expense is supported by an itemized receipt, and the claim is properly approved.</p> | <p><i>Agree. ALC revised and updated its travel and expense policies in June, 2016. The updated policies, now available on alc.ca, meet the recommendations of the Auditors General.</i></p>   |
| <p><b>Recommendation 3.6</b><br/>Atlantic Lottery should not buy event and concert tickets to give to government and elected officials in an effort to simply improve shareholder relations.</p>  | <p><i>Agree. ALC will immediately revisit this practice and will ensure that any hosting of government officials is extended only where detailed and clear business rationale is present.</i></p>  |
| <p><b>Recommendation 3.8</b><br/>Atlantic Lottery should include appropriate performance measures in vendor contracts. These should be established prior to signing the contract.</p>   | <p><i>Agree. Vendor performance management and scorecards are a critical deliverable within the supply chain function. As of September 1, 2016, ALC will ensure that all significant contracts include documented performance measures prior to signing.</i></p>   |
| <p><b>Recommendation 3.9</b><br/>Atlantic Lottery should ensure vendors provide detailed invoices that adequately describe the services provided.</p>   | <p><i>Agree. ALC will ensure that vendor invoices provide sufficient details that clearly reference goods and services delivered, and purchase orders and contracts if applicable.</i></p>   |
| <p><b>Recommendation 3.10</b><br/>Atlantic Lottery should ensure payments to vendors are only made once the appropriate ALC staff confirms that services billed were received.</p>  | <p><i>Agree. The practice of pre-billing for IT services will be discontinued as of Oct. 1, 2016. Regarding the reference to the invoice for over \$1 million, this was a standard, monthly pre-billing arrangement made in accordance with the terms of a well-documented contract. The contract called for a fixed amount to be pre-billed and paid at the beginning of the month with a reconciliation of services performed during the month to take place subsequently along with adjustments, if any. This particular pre-bill invoice did not have documented business owner approval due to availability which is an exception to our defined process; however, the reconciliation of services did subsequently take place</i></p> |
| <p><b>Recommendation 3.11</b><br/>Atlantic Lottery should document contract monitoring processes, including responsibilities for contract monitoring, and follow up to help ensure the required processes are completed.</p>  | <p><i>Agree. ALC will continue to improve its contract monitoring processes to ensure roles and responsibilities are clear and to apply a consistent approach to vendor and contract management and reporting.</i></p>   |



| <b>Recommendations at a Glance</b>  | <b>Atlantic Lottery Corporation Responses</b>   |
|---|---|
| <p><b>Recommendation 3.12</b><br/>Atlantic Lottery should review its controls around purchases of services to help ensure they are operating effectively.</p> | <p><i>Agree. ALC strives to maintain fair and equitable opportunities for all suppliers. The Corporation's Supply Chain Management Procurement Standard is based on the Atlantic Procurement Agreement which states clearly that services costing above a \$50,000 threshold must be procured through a public tendering process. As per the Auditors General's recommendations, Management will ensure this process is followed.</i></p> |

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# 3 Non-Governance

## Audit Objectives and Scope

- 3.1 Between fall 2015 and spring 2016, we completed a performance audit of Atlantic Lottery Corporation. The audit was conducted under the authority given to the Auditors General of New Brunswick, Newfoundland and Labrador, Nova Scotia, and Prince Edward Island, and in accordance with auditing standards of the Chartered Professional Accountants of Canada. Our audit covered the period from April 1, 2013 to August 31, 2015. Audit work was substantially completed by May 2016.
- 3.2 We completed this audit because Atlantic Lottery Corporation is a significant Crown corporation, owned by the governments of the four Atlantic Provinces. Auditors General last completed a performance audit of the Corporation in 1996.
- 3.3 The objectives of the audit were to determine:
- whether Atlantic Lottery Corporation's executive and employee compensation and benefits are appropriately managed;
  - whether travel, hospitality, and board expenses are managed in a transparent manner that promotes the appropriate use of shareholder money;
  - whether significant contracts are monitored to ensure services are received, and payments made, in accordance with contract terms;
  - whether Atlantic Lottery Corporation assesses the effectiveness of significant contracts in meeting its objectives and achieving enterprise value; and
  - whether Atlantic Lottery Corporation procures required services in an efficient and economical manner.
- 3.4 Generally accepted criteria consistent with the objectives of the audit did not exist. Audit criteria were developed specifically for this engagement. Criteria were accepted as appropriate by senior management and the Corporation's Board of Directors. The criteria used can be found in Appendix II. Our audit approach included reviewing relevant corporate and Board policies and documentation, along with interviewing and surveying management, staff and Board members; and testing compliance with specific policies.

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**Significant Audit Observations****Executive and Employee Compensation and Benefits**

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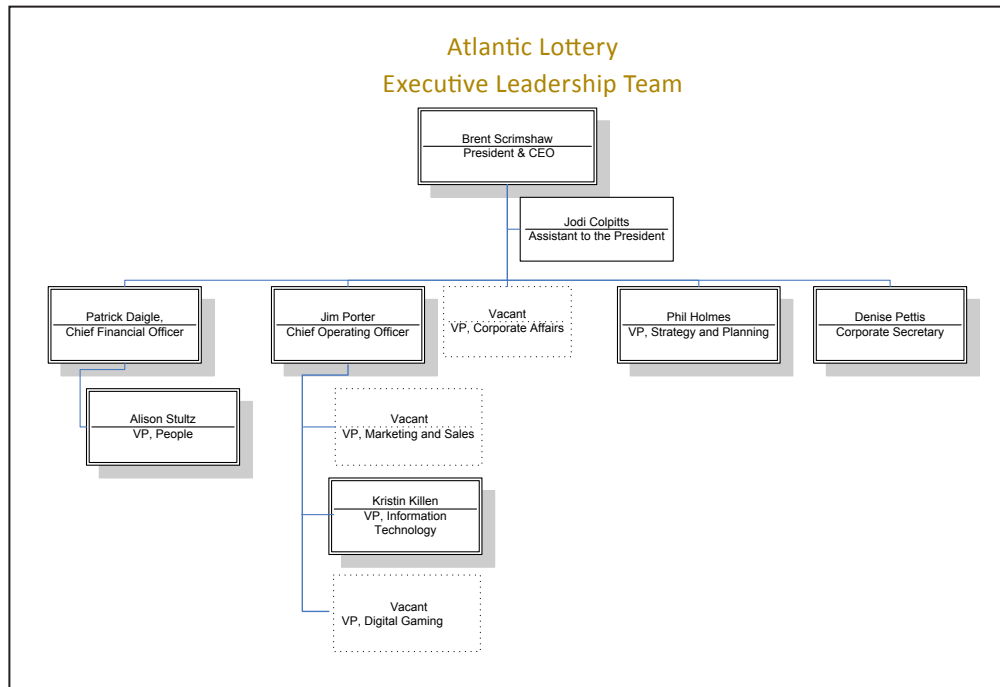
## Conclusion and summary of observations

Overall, Atlantic Lottery's compensation and benefits are managed and paid in accordance with documented policies. However, improvements are needed in Atlantic Lottery's management of executive and employee compensation and benefits. Any adjustments made should take into consideration the economic environments of the shareholder governments.

There was a lack of consultation with shareholder governments to determine their expectations related to compensation. Specifically, large increases in compensation were awarded to executives beginning in 2014-15, with some of the increases being phased in over a three-year period. The increases in base salary ranged from 20 to 40 percent, while increases to the maximum annual bonus ranged from 50 and 220 percent. We recommended the Board seek direction from shareholder governments on whether the Corporation's executive compensation is in line with shareholder expectations. Furthermore, we identified a lack of public disclosure of salaries. We also noted the Corporation contributed more than it should have to the pension plan for two years before the error was discovered and corrected.

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- 3.5 *Background* – Atlantic Lottery has approximately 600 employees across the four Atlantic Provinces. During the 2014-15 fiscal year, salary and benefit expenses for Atlantic Lottery were approximately \$37 million, accounting for 20 percent of the company's total operating expenses. Atlantic Lottery offers all employees a compensation package that includes base salary along with the potential to earn annual, merit-based pay increases and bonuses. Atlantic Lottery employees do not receive separate cost-of-living increases. Benefits include participation in a defined benefit pension plan, along with health and dental benefits. In addition, executives are also entitled to other benefits, including a vehicle allowance and extended health benefits.
- 3.6 *Policies* – Atlantic Lottery has policies which outline job classifications, performance evaluations, salary increases, and bonuses. For 2013-14 and 2014-15, we examined salaries and benefits for all executive team members, along with a sample of nonexecutive employees, to determine if individuals were paid the correct salary based on their job classification, and whether annual pay increases and bonuses were calculated accurately. Our sample included 39 individuals for the 2013-14 fiscal year, and 37 individuals for the 2014-15 fiscal year. Overall, we found individuals were paid the correct salary, and pay increases and bonuses were calculated accurately. However, we also identified several areas in which improvements are needed in managing compensation and benefits.

Exhibit 3.1



- 3.7 *Compensation review* – In 2013-14, Atlantic Lottery hired a consultant to complete a compensation review for both executives and nonexecutives. Based on that review, the Board of Directors selected and approved a comparator market for compensation comparison: 75 percent of the broader public sector and 25 percent of commercial organizations. For nonexecutive employees, Atlantic Canadian markets were used. For executive employees, the comparator market was national.
- 3.8 *Nonexecutive compensation* – The compensation review concluded that the total compensation package for nonexecutives was consistent with the Atlantic Canadian comparator market.
- 3.9 *Annual bonuses for nonexecutives* – For 2013-14 and 2014-15, nonexecutive employees could have earned an annual bonus of 2.5 percent to 7.5 percent of base salary, depending on their level within the Corporation. The range increased to 2.5 percent to 9.5 percent for 2015-16. The bonus is based on a combination of individual and corporate performance. The compensation review noted annual bonuses are not prevalent in the broader public sector. Similarly, bonuses are not common in the compensation packages provided to employees of the four shareholder governments. However, as noted above, the total nonexecutive compensation, including bonuses, is similar to the Atlantic Canadian comparator market.
- 3.10 *Employee merit increases* – Atlantic Lottery does not provide cost-of-living increases. In addition to any bonuses, 93 percent of Atlantic Lottery

employees were entitled to receive an annual increase in salary, from two to six percent, based the employee's annual performance review and rating (range from one to five). Increases are awarded up to the maximum pay for a position. Exhibit 3.2 below provides a summary of the actual salary increases for all employees in 2014-15.

**Exhibit 3.2**

| 2014-15 Salary Increases |                    |                         |
|--------------------------|--------------------|-------------------------|
| Performance Rating       | Increase in Salary | Percentage of Employees |
| 1                        | 0%                 | 3%                      |
| 2                        | 0%                 | 4%                      |
| 3                        | 2%                 | 79%                     |
| 4                        | 4%                 | 13%                     |
| 5                        | 6%                 | 1%                      |

- 3.11 *Increases in executive compensation* – As discussed earlier, the 2013-14 review used a national comparator market for executive compensation. The rationale for the national comparator was not well supported. Atlantic Lottery management indicated that a national market was needed to address challenges in attracting and retaining executives. While we recognize there has been some turnover within Atlantic Lottery's executive team in recent years, Corporation management was not able to provide sufficient support to confirm compensation was a key factor contributing to this turnover.
- 3.12 The compensation review concluded that executive compensation was below the national comparator market. To address this, the Board approved significant changes to executive compensation for the 2014-15 fiscal year. An overview of these changes is provided in Exhibit 3.3.

**Exhibit 3.3**

|  | Prior to Compensation Review (2013-14) | Subsequent to Compensation Review (2014-15) | Phase-in Period | Percent Change |
|--|--|---|-----------------|----------------|
| <b>Chief Executive Officer (CEO)</b>                                   |  |   |                 |                |
| Base salary  | \$255,502                              | \$255,502                                   | 1 Year          | 0%             |
| Maximum annual bonus – %   | 17%                                    | 26%   | 1 Year          |                |
| Maximum annual bonus – amount  | \$43,350                               | \$66,300                                    |                 | 53%            |
| <b>Total</b>   | <b>\$298,350</b>                       | <b>\$321,300</b>                            |                 | <b>8%</b>      |
| <b>Chief Operating Officer (COO) and Chief Financial Officer (CFO)</b> |  |   |                 |                |
| Base salary (high range)   | \$199,800                              | \$278,000                                   | 3 Years         | 39%            |
| Maximum annual bonus – %   | 10%                                    | 23%   | 1 Year          |                |
| Maximum annual bonus – amount  | \$19,980                               | \$63,940                                    |                 | 220%           |
| <b>Total (high range)</b>  | <b>\$219,780</b>                       | <b>\$341,940</b>                            |                 | <b>56%</b>     |
| <b>Vice President</b>  |  |   |                 |                |
| Base salary (maximum)  | \$173,160                              | \$204,000                                   | 1 Year          | 18%            |
| Maximum annual bonus – %   | 10%                                    | 14%   | 1 Year          |                |
| Maximum annual bonus – amount  | \$17,316                               | \$28,560                                    |                 | 65%            |
| <b>Total (maximum)</b>   | <b>\$190,476</b>                       | <b>\$232,560</b>                            |                 | <b>22%</b>     |

3.13 The base salary for the Chief Executive Officer is established in his employment contract. For the 2014-15 fiscal year, the CEO’s salary was \$268,277, which reflected a 2013-14 merit increase of five percent. The Board did not change the CEO’s base salary after the compensation review. To earn the full 26 percent annual bonus, the CEO must surpass annual performance targets. Otherwise, the bonus is 17 percent. Changes to COO and CFO salary are being phased in over the three-year period from 2014-15 to 2016-17.

3.14 As a result of changes to executive compensation, it is possible that the Chief Operating Officer and Chief Financial officer could earn more than the Chief Executive Officer. The top of the salary and bonus range for the COO and CFO is higher than the CEO’s total maximum compensation. The maximum salary and bonus for the Chief Operating Officer and Chief Financial Officer is approximately \$342,000 while for the Chief Executive Officer it is approximately \$321,000. However, in 2014-15 the total of the Chief Executive Officer’s salary and bonus was greater than what was paid to the COO and CFO. Actual salaries excluding bonuses for the Chief Operating Officer and Chief Financial Officer for 2014-15 were \$240,365 and \$224,819 respectively.

3.15 While the comparator markets used for the compensation review and the resulting increases were approved by Atlantic Lottery’s Board of Directors, which includes representatives from each shareholder government, shareholder governments were not specifically consulted to determine if the increases were consistent with shareholder government expectations for

public sector entities. Annual public sector cost-of-living increases in the shareholder provinces are provided in Exhibit 3.4.

**Exhibit 3.4**

| <b>Annual Public Sector Salary Increases</b> |  |                |                |
|--|--|----------------|----------------|
|  | <b>2013-14</b>                                 | <b>2014-15</b> | <b>2015-16</b> |
| New Brunswick                                | 0%   | 0%             | 1.0%           |
| Newfoundland and Labrador                    | \$1,400 signing bonus<br>No increase in salary | 2.0%           | 3.0%           |
| Nova Scotia                                  | 2.5%   | 3.0%           | 0%             |
| Prince Edward Island                         | 0.5%   | 1.5%           | 1.5%           |

3.16 An overview of total executive compensation, including benefits, once the changes from the compensation review have been fully implemented by the end of fiscal 2016-17 is outlined in Exhibit 3.5. For the Chief Executive Officer total compensation is determined using the 2014-15 base salary. As previously noted, the Chief Executive Officer salary is set in the employment contract and may be adjusted annually for merit increases.

**Exhibit 3.5**

|                                     | <b>Chief Executive Officer</b> | <b>Chief Operating and Financial Officers</b> | <b>Vice Presidents</b> |
|-------------------------------------|--------------------------------|---|------------------------|
|                                     |                                | <b>Maximum</b>                                | <b>Maximum</b>         |
| <b>Base Salary</b>                  | \$268,277                      | \$278,000                                     | \$204,000              |
| Maximum annual bonus                | \$69,752                       | \$63,940                                      | \$28,560               |
| Total salary and bonus              | \$338,029                      | \$341,940                                     | \$232,560              |
| <b>Benefits</b>                     |                                |   |                        |
| Employer pension contribution (10%) | \$26,828                       | \$27,800                                      | \$20,400               |
| Health and Dental                   | \$1,955                        | \$1,955                                       | \$1,955                |
| Car Allowance                       | \$15,600                       | \$13,800                                      | \$13,800               |
| Executive medical                   | \$4,000                        | \$4,000                                       | \$1,400                |
| <b>Total benefits</b>               | \$48,383                       | \$47,555                                      | \$37,555               |
| <b>Total Compensation</b>           | <b>\$386,412</b>               | <b>\$389,495</b>                              | <b>\$270,115</b>       |

*Note: In 2015 a Supplemental Employee Retirement Plan for executives was implemented to address the difference between the maximum salaries on which pensions are based under the Income Tax Act.*

**Recommendation 3.1**

Atlantic Lottery's Board of Directors should get direction from the four shareholder governments on the Corporation's approach to its compensation packages, including salaries, bonuses, pensions, and other benefits, to determine if it is aligned with shareholder expectations.

***Atlantic Lottery Corporation Response:*** *Agree. The Board will continue to fulfill its governance responsibility in this area. It will seek input and counsel from Shareholders annually and ensure that they are appropriately informed. The Board will ensure that compensation reflects economic and market conditions. It will rely on expert, external advice based on appropriate comparator groups and will also continue to employ a rigorous performance management system as part of the science supporting ALC's total rewards program.*

- 3.17 One member of the executive team has a negotiated employment contract with the Corporation that offers a different compensation package than what is outlined in Exhibit 3.5. The contract has a base salary of \$199,800 with a maximum annual bonus of 30 percent of base salary. Bonuses for 2013-14 and 2014-15 were approximately \$60,000 and \$53,000 respectively. For 2013-14, the maximum bonus was awarded. The majority of this bonus was based on achieving objectives that had been established between this individual and the Chief Executive Officer. The performance evaluation assessed the individual's annual performance against deliverables and a score of between one and five was awarded. However, there was nothing to state what level of bonus would be awarded based on the individual's performance score. For example, what the bonus would be for a score of three versus a score of five. As a result, we could not assess whether awarding the maximum bonus was appropriate.
- 3.18 *Pension* – Atlantic Lottery employees participate in the Council of Atlantic Premiers defined benefit pension plan. This is a multi-jurisdictional plan that includes other employers across the Atlantic Provinces, however Atlantic Lottery employees make up the majority of members. The Corporation's pension contribution rate is actuarially determined while the employees contribution rate is set by the employers included in the plan.
- 3.19 Unlike the majority of pension plans for the shareholder governments, employees and the Corporation do not contribute equal amounts to the pension plan. The Corporation's contribution rate is higher than the employee rate. As an example, we show the differences between employee and employer contributions to the pension plan for 2015 for an employee making \$75,000 per year. The summary in Exhibit 3.6 shows that the Corporation pays 25 percent more than the employees, while in Newfoundland and Labrador, Nova Scotia, and Prince Edward Island, employees and employers pay equal amounts.



**Exhibit 3.6**

|  | <b>Atlantic Lottery</b>  | <b>New Brunswick</b>            | <b>Newfoundland and Labrador</b>                   | <b>Nova Scotia</b>                 | <b>Prince Edward Island</b>       |
|--|--|---------------------------------|--|------------------------------------|-----------------------------------|
| Plan Name  | Pension Plan for Employees of Council of Atlantic Premiers and Participating Employees | Public Service Shared Risk Plan | Public Service Pension Plan                        | Public Service Superannuation Plan | Civil Service Superannuation Fund |
| Type of plan   | Defined benefit  | Shared risk*                    | Defined benefit                                    | Defined benefit                    | Defined benefit                   |
| Employee contribution up to year's maximum pensionable earnings  | 7.3%   | 7.5%                            | 10.75% of the first \$3,500 of earnings then 8.95% | 8.4%                               | 8.09%                             |
| Employee contribution beyond year's maximum pensionable earnings | 9.95%  | 10.7%                           | 11.85%   | 10.9%                              | 9.75%                             |
| Employer contribution  | 10%  | 12.5% to December 31, 2018      | Same as employee                                   | Same as employee                   | Same as employee                  |
| Employee contribution based on an annual salary of \$75,000      | \$6,042  | \$6,310                         | \$7,396  | \$6,835                            | \$6,423                           |
| Employer contribution based on an annual salary of \$75,000      | \$7,500<br>(25% more than employee contributions)                                      | \$9,375                         | \$7,396  | \$6,835                            | \$6,423                           |

\* Under this type of plan a retirement benefit is targeted but not guaranteed as in a defined benefit pension plan. Initially, the Province of New Brunswick is paying a higher contribution rate than employees, but will eventually transition to an even split as provided for in the New Brunswick pension plan changes.

3.20 *Pension-deficit funding* – Since the majority of pension plan members reside in New Brunswick, the Council of Atlantic Premiers pension plan is registered under the New Brunswick Pension Benefits Act. The Act requires the use of solvency valuations which hypothetically assume the plan would be dissolved. While plan assets exceed liabilities, from a solvency perspective, there was a \$79 million shortfall. Based on the 2014 plan valuation calculations this shortfall stood at \$60 million. The New Brunswick Pension Benefits Act prescribes minimum contributions that participating employers must pay to fund this deficit. Under the Act, these additional contributions are the

responsibility of the Corporation. Currently, Atlantic Lottery is required to pay approximately \$14 million per year to fund this deficit; this is expected to continue until 2019 when the funding shortfall is expected to be made up. Atlantic Lottery has requested an exemption from solvency payments, similar to the exemption provided to universities and municipalities under the Act. These additional payments are deducted from profits distributed to the four shareholder governments. Annual payments per province are provided in Exhibit 3.7.

**Exhibit 3.7**

| Annual Pension-deficit Funding per Province<br>2013–2019 (\$ millions) |                                    |               |                           |             |                      |
|--|------------------------------------|---------------|---------------------------|-------------|----------------------|
|  | Atlantic Lottery Corporation Total | New Brunswick | Newfoundland and Labrador | Nova Scotia | Prince Edward Island |
| Total Repayment  | \$78.7                             | \$20.9        | \$20.6                    | \$26.6      | \$10.6               |
| Annual Amount  | \$14                               | \$3.7         | \$3.6                     | \$4.8       | \$1.9                |

3.21 *Pension changes* – During our audit period, changes were made to improve the sustainability of the Corporation’s pension plan. The option for members to take a lump-sum settlement rather than a pension was eliminated and the maximum post-retirement indexing to three percent was reduced from six. Atlantic Lottery has recommended additional plan design changes to the Council of Atlantic Premiers. These include basing pensions on an individual’s career average earnings as opposed to his or her five best years, and introducing further limitations on indexing. As of June 2016, these had not been approved. In January 2016, a pension review led by senior government officials from the four Atlantic Provinces was initiated. The review is to examine the governance, administration, and sustainability of the pension plan and is to include considering the recommendations made by Atlantic Lottery.

**Recommendation 3.2**

The shareholder governments should complete the ongoing review of the Council of Atlantic Premiers pension plan and implement required changes.

*Shareholder Response:* Agree. The shareholders agree that the pension review that was initiated in January 2016 will be completed. The review will examine the governance, administration and sustainability of the pension plan.

3.22 *Pension contributions* – During the audit period, changes to the Corporation’s pension contribution rate were not properly reflected in its payroll system due to a lack of communication and awareness of the change. As a result,

Atlantic Lottery overpaid pension plan contributions. The actual rate paid versus the correct rates are detailed in the exhibit below. The error was not identified until January 2016. This resulted in a \$63,000 overpayment by ALC; future payments were adjusted to account for this.

**Exhibit 3.8**

| Pension Contribution Rate Errors: 2014 and 2015 |               |              |
|---|---------------|--------------|
| Time Frame                                      | Rate ALC Paid | Correct Rate |
| January to September 2014                       | 11.24%        | 11.8%        |
| October 2014 to August 2015                     | 11.24%        | 8.4%         |
| September to December 2015                      | 11.24%        | 10%          |

3.23 In addition to not updating the payroll system to reflect contribution rate changes, we also identified instances in which individual employees' contributions to their pension plan exceeded the maximum allowable amount under the Income Tax Act. Since 2011, employee overcontributions totaled approximately \$24,000 and impacted four employees. Management told us this happened because the contribution limit was not properly set in the payroll system. Atlantic Lottery identified the issue in December 2015 and has addressed the overcontributions with the Canada Revenue Agency.

3.24 While the dollar impact of these errors was relatively small, these types of issues have the potential to be costly for both the Corporation and its employees. These errors went undetected for two to four years before Corporation staff identified the issues. This suggests additional controls are needed to prevent errors in the future.

**Recommendation 3.3**

Atlantic Lottery should establish a process to ensure required changes to its payroll system are made. The process should include communicating changes to the required staff and confirmation that changes are made.

*Atlantic Lottery Corporation Response: Agree. Effective immediately, ALC will establish a process to ensure required changes are made to its payroll system. It will include communicating changes to the required staff and confirmation that changes have been made.*

3.25 *Public compensation disclosure* – Atlantic Lottery does not provide detailed compensation disclosure. While some information, such as average employee salary, is available on the Corporation's website, it is not detailed and is difficult to find. Public compensation disclosure enhances transparency and accountability for public funds and is a recognized best practice. Some of the shareholder governments have similar practices. For example, the Province of New Brunswick discloses the names of government employees, including those employed by Crown corporations, by salary range for those earning

\$60,000 or more per year. The Province of Nova Scotia publicly discloses the salaries of all government employees earning more than \$25,000 annually; also, public sector bodies within Nova Scotia such as universities, school boards, and the health authority are required to publicly disclose the names of individuals earning \$100,000 or more per year.

#### **Recommendation 3.4**

Atlantic Lottery should publicly disclose compensation information to promote accountability and transparency. Atlantic Lottery should consult shareholder governments on their expectations for this disclosure.

*Atlantic Lottery Corporation Response: Agree. As of August, 2016, ALC is disclosing full compensation details for its Executive Team, as well as the names and positions of all employees earning in excess of \$100,000. This will be updated annually and posted at alc.ca.*

### **Travel, Hospitality, and Board Expenses**

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#### Conclusion and summary of observations

Atlantic Lottery Corporation's travel, hospitality and board expenses are not managed with consideration for economy and transparency. While Atlantic Lottery has a travel and expense policy, we identified weaknesses in the policy and a lack of compliance with certain requirements. We noted that prior approval is not required for hospitality and entertainment expenses and the current policy does not address the appropriateness of alcohol as a corporate expense. We identified instances in which expenses were not properly approved or supported by appropriate receipts. This included instances of individuals approving expenses incurred on their behalf by other employees and a lack of receipts to support expenses. We also noted many expenses lacked a clear, documented explanation of the reason for the expenditure. We are concerned that Atlantic Lottery could not demonstrate whether some of its expenses for event tickets (AC/DC and the Cavendish Beach Music Festival) were an appropriate use of shareholder money. Some of the concert tickets purchased were distributed to members of the Board, executive team members, senior officials with shareholder governments, elected officials, and political staff of shareholder governments. Also, with regards to economy, we identified \$111,000 in expenses related to staff Christmas parties and events during our audit period.

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3.26 *Background* – Atlantic Lottery has a travel and expense policy for employees and Board members which outlines requirements for reimbursing travel and entertainment expenses incurred while conducting Atlantic Lottery business. Approximately \$4 million was spent on travel, hospitality, and Board expenses over the audit period. We selected a sample of 59 expense items totaling roughly \$335,000. The majority of these were expense claims which included multiple line items.

- 3.27 *Travel and expense policy* – Atlantic Lottery’s travel and expense policy does not identify when alcohol might be an appropriate expense. In our sample, we identified approximately \$5,000 in alcohol expenses claimed at staff events and meetings with stakeholders. Approximately \$1,500 of this was subsequently reimbursed by employees and Board members.
- 3.28 Atlantic Lottery’s travel and expense policy allows employees to be reimbursed for reasonable meeting expenses incurred while conducting corporate business. However, the policy does not require that expenditures be preapproved. Preapproval of meeting and entertainment expenses promotes an awareness of spending in these areas and helps to ensure expenses are prudently managed. Some of Atlantic Lottery’s shareholder governments require approval in advance. Our sample included approximately \$24,000 in expenses related to business meetings with both staff internal and external to Atlantic Lottery.
- 3.29 *Noncompliance with policy* – We identified several instances of noncompliance with the travel and expense policy. Fifty-four samples were noncompliant with at least one requirement of the policy. Details are provided below.
- 14 of 59 samples were not appropriately approved
  - 17 of 59 sample items were missing appropriate receipts
  - 38 of 59 samples did not have an adequate description of the rationale or support for the expense
- 3.30 A number of the samples were noncompliant with more than one policy requirement, so the total number of issues is greater than the sample size of 59.
- 3.31 *Approvals* – Appropriate approvals were not obtained for 14 of 59 samples (totaling approximately \$87,000). A number of these expenses were instances of an individual booking a flight for their supervisor on a corporate credit card. The monthly corporate card expenditures had been approved by the supervisor, meaning the supervisor effectively approved his or her own expense. Appropriate approval requires an employee’s expenses to be approved by a more senior person in the organization. There were also instances in which expenses were not approved. Proper approval of expenses is needed to ensure only those expenses permitted under the travel and expense policy and incurred while conducting official corporate business are reimbursed.
- 3.32 We identified a number of instances in which Board member remuneration was approved by the Chief Executive Officer. We also identified another instance in which expenses incurred by the Chief Executive Officer were approved by an Atlantic Lottery manager. The Board Chair should approve Board

member remuneration and expenses and the Audit and Finance Committee Chair should approve Board Chair remuneration and expenses. Additionally, the Board Chair should also approve the Chief Executive Officer's expenses.

- 3.33 *Supporting documentation* – Appropriate receipts were not included for 17 of 59 samples tested (totaling approximately \$15,000). While there were a number of smaller expenses included in this total, there were also larger expenses for which we would expect to see itemized receipts. For example, there was approximately \$8,000 reimbursed without a receipt. Included in this total was \$5,400 for a deposit on a group of hotel rooms, along with other expenses for accommodations and rental cars. For the remaining \$7,000 in expenses reimbursed without appropriate support, an itemized receipt was not provided. This included a \$3,000 restaurant expense for a dinner for Board and executive members as part of the 2013 annual general meeting. All of the expenses we tested which lacked support were in fact reimbursed by Atlantic Lottery without being flagged or stopped. Without detailed receipts, the nature and amount claimed for reimbursement cannot be verified by the person authorizing payment of the expense claim.
- 3.34 *Description of expenses* – Thirty-eight of 59 samples (totaling \$119,000) did not have a description of the expense that adequately documented the rationale and support for the expense. Without an explanation as to why the expense was incurred, it is not possible to conclusively determine that these expenses related to Atlantic Lottery business. Examples of this are listed below.
- Airfare, including a \$1,300 flight to New York
  - Rental vehicles
  - Business meetings with internal and external parties, including a \$700 dinner with stakeholders

### **Recommendation 3.5**

Atlantic Lottery should revise its travel and expense policy to:

- address whether alcohol is an acceptable expense;
- require meeting and entertainment expenses to be preapproved; and
- address appropriate approvals for Board member and CEO expenses.

Expenses should only be reimbursed if an adequate description is provided, the expense is supported by an itemized receipt, and the claim is properly approved.

***Atlantic Lottery Corporation Response:*** *Agree. ALC revised and updated its travel and expense policies in June, 2016. The updated policies, now available on [alc.ca](http://alc.ca), meet the recommendations of the Auditors General.*

- 3.35 *Stakeholder relations spending* – The sample included approximately \$73,000 claimed for tickets to various sporting events and concerts which were used for stakeholder relations. Of significance is \$14,000 for 125 tickets to the 2014 Cavendish Beach Music Festival and \$48,000 for 300 tickets to the 2015 AC/DC concert in Moncton.
- 3.36 Atlantic Lottery is a major sponsor of the Cavendish Beach Music Festival. As a sponsor of the 2014 event, the Corporation received 270 tickets (90 tickets for each day of the three-day event). The 125 tickets noted above were in addition to the 270 tickets Atlantic Lottery received as sponsors. The majority of the 125 additional tickets were distributed to Atlantic Lottery Board members and executives; Atlantic Provinces senior government officials and elected officials; and political staff members from the Atlantic Provinces. We were unable to satisfy ourselves that the Corporation appropriately determined why the extra tickets were purchased and the value received from their distribution.
- 3.37 The majority of tickets to the AC/DC concert were used for various player and retailer promotions. However, 26 tickets were given to senior government officials and elected officials from one of the shareholder governments.
- 3.38 Management told us they believe that events such as these concerts provide an opportunity to engage with stakeholders in an informal setting. However, management have not supported this by facts or analysis. Additionally, the Corporation does not know whether tickets were actually used by the stakeholders who received them and cannot therefore demonstrate actual value for money.
- 3.39 These expenditures by Atlantic Lottery, as currently administered, do not demonstrate an appropriate use of shareholder money.

**Recommendation 3.6**

Atlantic Lottery should not buy event and concert tickets to give to government and elected officials in an effort to simply improve shareholder relations.

*Atlantic Lottery Corporation Response: Agree. ALC will immediately revisit this practice and will ensure that any hosting of government officials is extended only where detailed and clear business rationale is present.*

- 3.40 *Christmas event expenses* – Our sample included approximately \$14,000 in expenses for the Corporation’s 2013 Moncton-location Christmas party. We examined accounting records for the April 1, 2013 to August 31, 2015 audit period and identified approximately \$111,000 on a variety of staff Christmas parties and events, such as team lunches, over that period. We did not further test these other expenses identified. It is not appropriate use of Atlantic Canadian’s money for Atlantic Lottery to be incurring these expenses.



3.41 *Employee recognition program* – Between 2013 and 2015, there were approximately \$170,000 in expenses spent on the Corporation’s employee recognition program. Awards under this program include: employee employment anniversaries and retirements, sales incentives, recognition of life events such as births and bereavements, and recognition of employee performance. Items received under this program are a taxable benefit to the employee. Atlantic Lottery has policies outlining the amount of awards for anniversaries and retirements and when these should be given. However, there is a lack of policy guidance in the other areas. For example, awards to recognize employee performance are made at the discretion of managers. While approximately 80 percent of the awards were valued under \$200, there were 17 instances in which an award was valued between \$1,000 and \$2,000. Without appropriate policy guidance around the employee recognition program, there is a lack of transparency on what should be recognized, as well as the value of the award. There is also a risk that the program may not be consistently applied across the Corporation.

**Recommendation 3.7**

Atlantic Lottery Board should set policies on spending related to Christmas events and the employee recognition program that are in line with shareholder governments’ expectations.

*Atlantic Lottery Corporation Response: Agree. Atlantic Lottery believes that strong morale and a highly motivated staff are an important part of its success. That said, it fully understands that this is a time of economic restraint in Atlantic Canada. As such, effective immediately, we will do the following:*

1. *Eliminate ALC supported holiday events.*
2. *Establish formal protocols for employee performance recognition by December, 2016.*

**Contract Management**

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Conclusion and summary of observations

Atlantic Lottery monitors contracts to help ensure services are received and payments are made in accordance with contract terms. Contract effectiveness is regularly assessed, but the processes have not been documented and formalized within the Corporation. This increases the risk that contracts will not be consistently monitored.

Overall, Atlantic Lottery includes terms and conditions in vendor contracts to protect the Corporation. Contracts are monitored to ensure services are received. Vendors are evaluated regularly, but specific contract monitoring processes have not been documented, which creates a risk of inconsistent practices within the Corporation. We identified instances in which invoices from a vendor did not



provide adequate description of services billed. In one instance, an invoice of over \$1 million was paid without confirmation from the appropriate Atlantic Lottery staff that the service had been received.

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- 3.42 *Background* – Contract management involves monitoring vendor performance against original objectives. This begins after the procurement stage, when contract negotiations and drafting take place. Over the term of the contract, vendor performance is measured against expectations and objectives originally identified in the request for proposal and subsequent contract negotiations. Contract management also includes controls over payments and processes for making changes or terminating the contract.
- 3.43 During the audit period, Atlantic Lottery spent \$107 million on outsourced services from 11 key suppliers. These suppliers were identified by Atlantic Lottery as critical to their operations. They provide services related to information technology, gaming products, and marketing. Appropriate vendor contract management is needed to help ensure services are delivered as intended and payments are made in accordance with contract terms.
- 3.44 We selected a sample of four contracts from these vendors to examine in more detail. Total spending over the audit period was \$85 million.
- 3.45 *Contract terms* – We examined the contracts to determine if there were terms to protect the Corporation and contract terms were consistent with the request for proposal. In all four samples, we found no discrepancies between the request for proposal and the final contract signed with the vendor.
- 3.46 Atlantic Lottery has a standard vendor contract template that includes terms such as the right to audit vendors, insurance requirements, and processes for cancelling the contract. For three of the four contracts we examined, the contract template was used. In each of these cases, the contract included terms to protect the Corporation.
- 3.47 The remaining contract, for information technology services, was signed in 2010, for seven years. This contract was missing key terms that protect the Corporation, such as a performance bond to guarantee fulfillment of the contract and ability to enforce the performance expectations outlined in the contract. Management told us this was due to a lack of expertise in drafting a contract of this nature. A new vendor has been selected to replace the existing vendor when the contract expires in 2017. External consultants with information technology-specific experience were used to help select the new vendor and are also being used to assist in preparing the new contract to help avoid the shortcomings of the previous contract.
- 3.48 For another contract in our sample, the section related to performance measurement simply stated that measures would be co-developed by

the vendor and Atlantic Lottery if required; but this was not completed. Performance measures should be established for all significant contracts and included in the contract prior to signing. This allows for better contract monitoring, ensures all parties are informed of expectations at the outset, and may avoid unnecessary conflict.

**Recommendation 3.8**

Atlantic Lottery should include appropriate performance measures in vendor contracts. These should be established prior to signing the contract.

**Atlantic Lottery Corporation Response:** *Agree. Vendor performance management and scorecards are a critical deliverable within the supply chain function. As of September 1, 2016, ALC will ensure that all significant contracts include documented performance measures prior to signing.*

3.49 *Payments* – We tested a sample of 20 payments made under the four contracts examined to determine whether invoicing was consistent with contract terms and payments were properly approved. Invoices should be detailed enough so that services and the amount billed can be linked to the contract and there should be confirmation from Atlantic Lottery staff that services billed were actually provided prior to paying the vendor.

3.50 For one of the vendors, invoices only included the total for services billed by category of cost under the contract. There were no details of the specific services provided under each category, making it difficult to know which services were delivered. Atlantic Lottery relies on staff with knowledge of the contract and services provided to review invoices prior to payment to confirm that billings are consistent with services received from the vendor and the fees are as outlined in the contract. We identified one invoice of over \$1 million in which this confirmation was not provided prior to the Corporation paying the vendor. This is a key control lapse that should not occur.

**Recommendation 3.9**

Atlantic Lottery should ensure vendors provide detailed invoices that adequately describe the services provided.

**Atlantic Lottery Corporation Response:** *Agree. ALC will ensure that vendor invoices provide sufficient details that clearly reference goods and services delivered, and purchase orders and contracts if applicable.*

**Recommendation 3.10**

Atlantic Lottery should ensure payments to vendors are only made once the appropriate ALC staff confirms that services billed were received.

**Atlantic Lottery Corporation Response:** *Agree. The practice of pre-billing for IT services will be discontinued as of Oct. 1, 2016. Regarding the reference to the invoice for over \$1 million, this was a standard, monthly pre-billing arrangement made in accordance with the terms of a well-documented contract. The contract called for a fixed amount to be pre-billed and paid at the beginning of the month with a reconciliation of services performed during the month to take place subsequently along with adjustments, if any. This particular pre-bill invoice did not have documented business owner approval due to availability which is an exception to our defined process; however, the reconciliation of services did subsequently take place.*

3.51 *Contract monitoring* – We expected Atlantic Lottery to have a documented process for monitoring contracts which would include roles and responsibilities as well as procedures to be carried out. Atlantic Lottery has not documented its contract monitoring processes or established who within the Corporation is responsible for contract monitoring. However, despite the lack of a formalized policy, the contracts we tested were monitored. We found that Atlantic Lottery regularly evaluated vendor performance. In some instances, Atlantic Lottery hired consultants to complete the evaluation. Despite regular monitoring, a formalized contract monitoring process would improve the consistency across the organization and establish strong controls for contract monitoring.

**Recommendation 3.11**

Atlantic Lottery should document contract monitoring processes, including responsibilities for contract monitoring, and follow up to help ensure the required processes are completed.

**Atlantic Lottery Corporation Response:** *Agree. ALC will continue to improve its contract monitoring processes to ensure roles and responsibilities are clear and to apply a consistent approach to vendor and contract management and reporting.*

**Procurement of Services**

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Conclusion and summary of observations

Atlantic Lottery has a documented purchasing policy. Overall, Atlantic Lottery Corporation procures services in an efficient and economical manner even though we identified some areas in which improvements are needed.

Atlantic Lottery is generally in compliance with its purchasing policy, but we identified instances in which the policy was not followed that could impact the fairness of the process and the cost to the Corporation. Specifically, there was one instance in which a public tender should have been used to select a supplier, but

was not. There were several instances in which conflict of interest declarations were not obtained prior to selecting a vendor. When public tenders were used to select vendors, we found submissions were appropriately evaluated against the established criteria. We also found quotes were properly obtained for purchases that did not require public tendering. As well, the use of alternative procurement practices were justified by appropriate explanations.

3.52 *Purchasing policy* – Atlantic Lottery has a purchasing policy which outlines when various methods are to be used. Under the policy, services over \$50,000 must be purchased through a public tendering process. At least one quote is required prior to purchasing services equal to or below \$50,000. In emergency situations or instances where there are a limited number of qualified vendors, alternative procurement practices can be used to select vendors without public tender. Atlantic Lottery’s policy clearly describes situations when this is appropriate. Supplier roster lists for particular services are also established through a public bid process. A qualified vendor can be selected from the roster list, if required. With the exception of public tendering threshold for services, we did not find any significant differences between Atlantic Lottery’s purchasing policy and those of the four Atlantic Provinces. While the threshold to publicly tender for services varies across the Atlantic Provinces, Atlantic Lottery’s \$50,000 threshold is consistent with New Brunswick’s purchasing policy. We also found Atlantic Lottery’s policy to be consistent with the Atlantic Procurement Agreement.

3.53 *Compliance with procurement standard* – We tested a sample of 30 services purchased by Atlantic Lottery. The services were acquired through various purchasing methods as listed in Exhibit 3.9.

**Exhibit 3.9**

| Method of Purchase                         | Number of Sample Items |
|--|------------------------|
| Publicly tendered                          | 6                      |
| Quote – did not require public tender      | 9                      |
| Payment under existing contract            | 6                      |
| Alternative procurement practices          | 4                      |
| Standing offer/roster list                 | 4                      |
| Not publicly tendered but should have been | 1                      |

3.54 Overall, we found Atlantic Lottery complied with its purchasing policy.

- When public tendering was used, vendor submissions were appropriately evaluated against the criteria outlined in the tender documents and quotes were obtained for purchases below the public tendering threshold.
- We did identify one sample item which should have been publicly tendered. A previous contract with the vendor had expired and

additional services expected to cost \$100,000 were purchased without public tendering.

- The alternative procurements we tested were supported by appropriate documentation demonstrating that it would not have been practical to use a public tender.
- Roster purchases were made from suppliers selected through a public tender process and were for services the supplier was approved to provide.
- Our sample also included 15 payments to vendors which fell under existing ALC contracts or represented smaller purchases which did not require public tender. We did not note any issues with this testing.

3.55 *Conflict of interest declarations* – While Atlantic Lottery is generally complying with its procurement policy, we identified instances in which it did not follow its policy related to vendor conflict of interest. Atlantic Lottery’s purchasing standard states all vendors must include with their bid a declaration that they are not in a real or perceived conflict of interest with Atlantic Lottery. This is also a requirement for vendors selected through an alternative procurement practice. Of the ten sample items that required a conflict of interest declaration, we found the declarations were not provided in five of the cases. Conflict of interest declarations are needed to prevent private interests or personal considerations from influencing the selection of vendors.

3.56 Public tendering and obtaining conflict of interest declarations from vendors are not only necessary for promoting a fair, consistent and transparent purchasing process, but they also help Atlantic Lottery select vendors that can meet their requirements at the best possible price.

**Recommendation 3.12**

Atlantic Lottery should review its controls around purchases of services to help ensure they are operating effectively.

*Atlantic Lottery Corporation Response: Agree. ALC strives to maintain fair and equitable opportunities for all suppliers. The Corporation’s Supply Chain Management Procurement Standard is based on the Atlantic Procurement Agreement which states clearly that services costing above a \$50,000 threshold must be procured through a public tendering process. As per the Auditors General’s recommendations, Management will ensure this process is followed.*

### **Atlantic Lottery Corporation: Additional Comments**

*On behalf of Atlantic Lottery, we wish to thank the Auditors General for the time and effort they have invested in making ours a better company. Throughout this process, we have let transparency be our guide. A philosophy of continuous improvement has been the bedrock of Atlantic Lottery's success for 40 years; this audit delivers a welcome opportunity to become more efficient for the benefit of all Atlantic Canadians.*

*We recognize that these are not easy economic times. Now more than ever, our shareholder governments need the responsibly generated profits we work hard to deliver. While competition in the gaming space is getting tougher, our strong foundation of the right people, skills and technology mean our operations will continue to thrive and meet shareholder expectations.*

*Every dollar matters. Since 2012 we have reduced discretionary spending by 22% and scaled back full time equivalent roles (FTEs) by 8%.*

*We recognize that we have ample room for improvement. That said, our record is strong. Our annual profit growth over the past four years is at 3.95%, and just this past year, we generated record profits for the four provincial governments of this region.*

*None of that is grounds for complacency. We can and will do better. We have welcomed the many sound recommendations of the Auditors General. Some had been in a process of implementation prior to this work, several have been implemented and many more will be in the months ahead.*



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# Appendices

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## Appendix I: Corporate Governance Audit Criteria

**Objective:** To determine whether governance structures and processes create a framework for effective governance and are working well.

### Criteria

|   |
|---|
| 1: The mandate, mission and objectives of Atlantic Lottery Corporation should be clearly documented and agreed upon by all shareholders and the Board. These should be periodically reviewed to ensure they remain consistent with the needs of shareholders. |
| 2: The relative roles, responsibilities, and accountabilities of the shareholders and their representatives, the Board of Directors and its Committees, the CEO and management should be clearly documented and agreed upon by appropriate parties.           |
| 3: Shareholder performance expectations should be clearly communicated to the Atlantic Lottery Corporation Board. The Board should communicate performance expectations to senior management.   |
| 4: There should be regular public reporting on corporate performance.   |
| 5: The Board should develop and maintain a communication plan that promotes two-way communication with shareholders, key stakeholders, and other external parties who provide ongoing information to the Board.   |
| 6: The Board should receive appropriate and timely information to support decision-making and discharge its duty of care.   |
| 7: The Board appointment process should ensure candidates are independent and have the characteristics and skills that will best contribute to Board effectiveness. Processes should be clearly documented and consistently followed.                         |

## Appendix II: Non-Governance Audit Criteria

### Executive and Employee Compensation and Benefits

**Objective:** To determine whether Atlantic Lottery Corporation’s executive and employee compensation and benefits are appropriately managed.

#### Criteria

|   |
|---|
| 1: Atlantic Lottery Corporation should have compensation and benefit policies for executives and employees. Policies should be periodically reviewed to ensure they remain appropriate. |
| 2: Executive and employee compensation and benefits should be consistent with policies.   |
| 3: Executive and employee salaries and benefits should be based on appropriate comparator groups.   |
| 4: Performance-based compensation arrangements should be clearly defined and followed when making awards.   |
| 5: Information on executive and employee compensation should be publicly reported to promote transparency and be consistent with modern disclosure practices.                           |

### Travel, Hospitality, and Board Expenses

**Objective:** To determine whether travel, hospitality, and Board expenses are managed in a transparent manner that promotes the appropriate use of shareholder money.

#### Criteria

|  |
|--|
| 1: Atlantic Lottery Corporation should have policies that guide spending on travel, hospitality, and Board expenses and promote transparency and accountability. Policies should be periodically reviewed. |
| 2: Travel, hospitality, and board expenses should be in compliance with Corporation policies.  |

### Contract Management

**Objective 1:** To determine whether significant contracts are monitored to ensure services are received, and payments made, in accordance with contract terms.

**Objective 2:** To determine whether Atlantic Lottery Corporation assesses the effectiveness of significant contracts in meeting its objectives and achieving enterprise value.

#### Criteria

|  |
|--|
| 1: Final contract terms should be consistent with the detail contained in the approved request for proposals submissions and subsequent negotiations.  |
| 2: Contracts should include terms to protect the Corporation.  |
| 3: There should be processes to monitor contracts to ensure services are received and payments made in accordance with contract terms. Timely action should be taken when performance issues are identified. |
| 4: There should be processes to assess the effectiveness of contracts to determine whether objectives are met.   |

### Procurement of Services

**Objective:** To determine whether Atlantic Lottery Corporation procures required services in an efficient and economical manner.

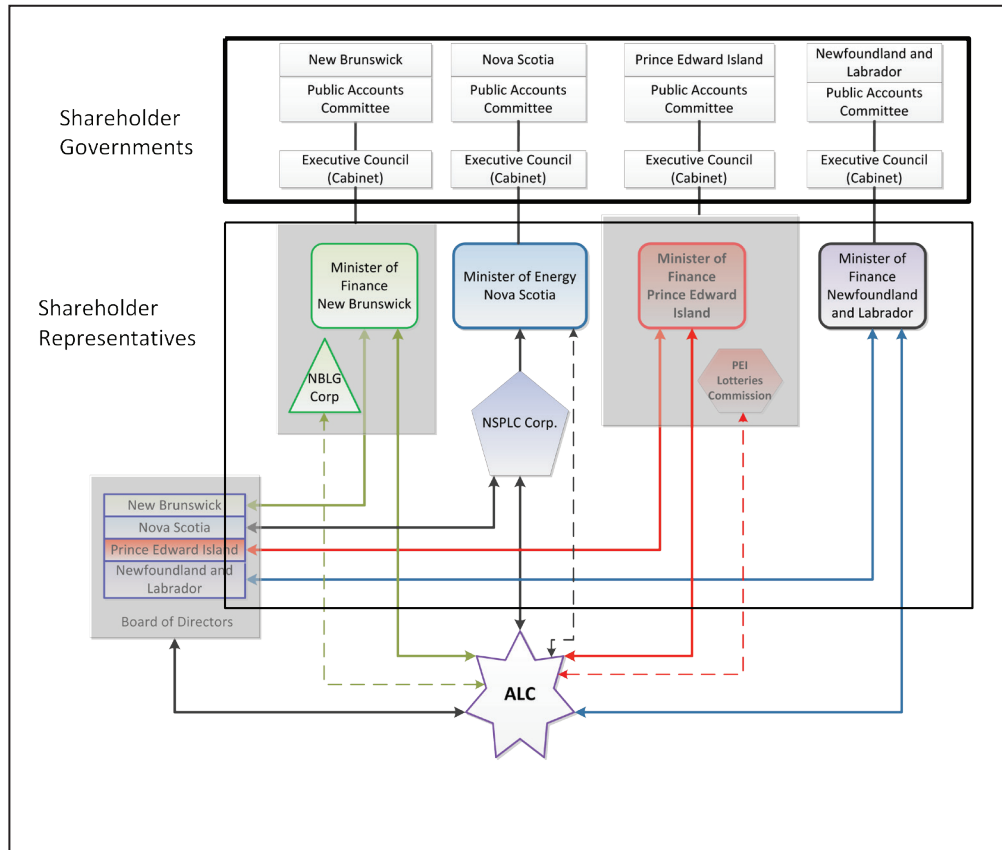
#### Criteria

|  |
|--|
| 1: There should be clear policies governing the procurement of services.   |
| 2: Procurement should be based on needs identified through business and risk management planning, strategic objectives, shareholder orientations and financial frameworks. |
| 3: The procurement of services should be in compliance with relevant procurement policies and procedures.  |
| 4: Evaluation criteria defined in tender documents should be followed when evaluating vendor proposals.  |

**Appendix III: Summary of Applicable Gaming Legislation and Governance Documentation**

| <b>Gaming Legislation and Atlantic Lotteries Governance</b>  |                                   |   |
|--|-----------------------------------|---|
| <b>Document</b>  | <b>Level</b>                      | <b>Summary</b>  |
| Section 207 Criminal Code of Canada  | Federal to Provinces              | Allows Province(s) to conduct and manage lotteries and gaming   |
| New Brunswick Gaming Control Act   | Provincial authority              | Delegation of authority to NBLGC  |
| Newfoundland and Labrador Lotteries Act  | Provincial authority              | Delegation of authority to Minister of Finance  |
| Nova Scotia Gaming Control Act part 1  | Provincial authority              | Delegate and grants authority to NSPLCC   |
| Prince Edward Island Lotteries Commission Act  | Provincial authority              | Delegation of authority to Commission   |
| Unanimous Shareholder Agreement<br>– Nova Scotia Agency Agreement<br>– Prince Edward Island Agency Agreement | Atlantic Lottery Corporation      | Agreement between four Atlantic Provinces for ALC to conduct and manage lotteries and gaming or operate lotteries |
| Business Corporations Act<br>Corporate By-Laws   | Atlantic Lottery Corporation      | ALC articles of incorporation<br>Board Governance framework   |
| Governance Manual, Terms of Reference, Charters  | Board of Directors and Management |   |

**Appendix IV: Entity Relationship – Diagram Mapping the Governance and Oversight Relationships of Atlantic Lottery Corporation**



*Prepared by OAG staff*

Note 1: Not reflected are the agent operator relationships associated with the agency agreement between Atlantic Lottery Corporation and Nova Scotia Provincial Lotteries and Casino Corporation. Also excluded are the regulatory components and relationships.

Atlantic Lottery Corporation executive (typically CEO) has a direct relationship with representatives within each provincial government and receives direction and input from each shareholder government. In the case of Nova Scotia however there is less of a direct relationship with the Minister. It is more often through Nova Scotia Provincial Lotteries and Casino Corporation, although there is still some direct interaction such as at the annual minister’s summit and as a Crown entity to the responsible Minister.