

Report 8: December 2012

## SUMMARY REPORT: RESULTS OF COMPLETED PROJECTS AND OTHER MATTERS

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**Auditor General**  
of British Columbia



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The Honourable Bill Barisoff  
Speaker of the Legislative Assembly  
Province of British Columbia  
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Victoria, British Columbia  
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Dear Sir:

It is my privilege to transmit to the Legislative Assembly of British Columbia my 2012/2013 Report 8:  
*Summary Report: Results of Completed Projects and Other Matters.*

Each year, my Office undertakes a number of projects that do not result in either traditional financial or performance audit reports. For a variety of reasons, unique to each piece of work, these projects do not need to be the subject of a traditional report to be completely beneficial. So as to be accountable for this work, we summarize the most important findings and recommendations from these performance audits and reviews in an annual public 'summary report.'

This is the third annual summary report issued by my Office. It includes summaries of five audit projects which cover off topics such as an update of government's implementation of the B.C. Reporting Principles, a preview of the Police Complaint Commissioner's audit, work undertaken by my Office's Investigations Group which reports out on several ongoing investigations, as well as an audit report on BC Transit and an examination of the New Westminster School District's Business Company.

John Doyle, MAcc, FCA  
*Auditor General*

Victoria, British Columbia  
December 2012

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**THIS IS THE THIRD OF MY SUMMARY REPORTS**, presented in December each year.

A great deal of work by the professionals in my Office regularly occurs outside the terms of my public reports. These summary reports enable us to be publicly accountable for our use of public sector resources. Furthermore, all the summaries are for projects that did not need to be the subject of a traditional, standalone public report, yet whose results are of benefit to each organization involved.

Through our communications with the public sector entities we are auditing, management is often aware of our general findings early in the engagement process. In many cases, management is even willing and able to begin addressing our findings during the engagement itself.

Five summaries are included in this report:

- ◆ “Update on Government’s Implementation of the BC Reporting Principles” itemizes the weaknesses we identified with the current common reporting framework and how it is not being adequately used to track performance success. We also found that after a few years of improvement, government’s commitment to the reporting principles has stalled since their official adoption in 2003. None of the organizations we examined had yet fully incorporated all the principles, which means that the full potential of these reports to enhance transparency and accountability to stakeholders is not being achieved.
- ◆ “School District Number 40 Business Company Examination” summarizes the need for a clearer, stronger governance relationship so that both boards – the “SD40BC” board of directors and the district’s board of education – can more effectively meet their respective responsibilities. Among our primary concerns: ensuring that board members have both the required skills and the objectivity to hold management accountable for performance, and that trustees comply with conflict of interest legislation.
- ◆ “An Audit of BC Transit’s Ridership Growth since the Launch of the 2008 Provincial Transit Plan,” highlighting BC Transit’s ridership issues in the future.



**JOHN DOYLE, MAcc, FCA**  
*Auditor General*

- ◆ Work undertaken by our Office's Investigations Group, including:
  - a high-level summary of our investigations at the Ministry of Health and "Organization A"; and
  - a preview of our audit of the Office of the Police Complaint Commissioner.

I thank the many people from the various organizations involved in each of these projects for their assistance and professionalism. Publishing this report allows me to recognize the good work being done in government, work that might not otherwise be publicly noted. At the same time, these undertakings enable me and my staff to build on the positive working relationship we have with the public servants of this province.



John Doyle, MAcc, FCA  
*Auditor General*

Victoria, British Columbia  
December 2012

## BACKGROUND

**THE AUDITOR GENERAL** regularly receives tips and suggestions for audit. These typically come from individuals, public interest groups and organizations, although public servants and Members of the Legislative Assembly sometimes also contact the Office asking the Auditor General to look into matters that are of concern to them.

All tips and suggestions for audit are held in confidence, and are referred to the OAG's Investigations Group. This work is undertaken in accordance with section 13 of the *Auditor General Act*.

### **“Contact Us” at [www.bcauditor.com](http://www.bcauditor.com) is an effective means of input**

Our website continues to be the most popular and effective way for people who are interested in our work to reach us. The “Contact Us” page ([www.bcauditor.com/reach](http://www.bcauditor.com/reach)) invites readers to submit their feedback, comments, concerns or queries, including suggestions for audit. Each submission is reviewed, considered and, where possible, responded to. The website allows for the anonymous submission of information, so it is not always possible for us to reply to every contact. Being responsive to external suggestions is important to us; one of our key performance indicators measures the proportion of audit reports initiated by an external suggestion.

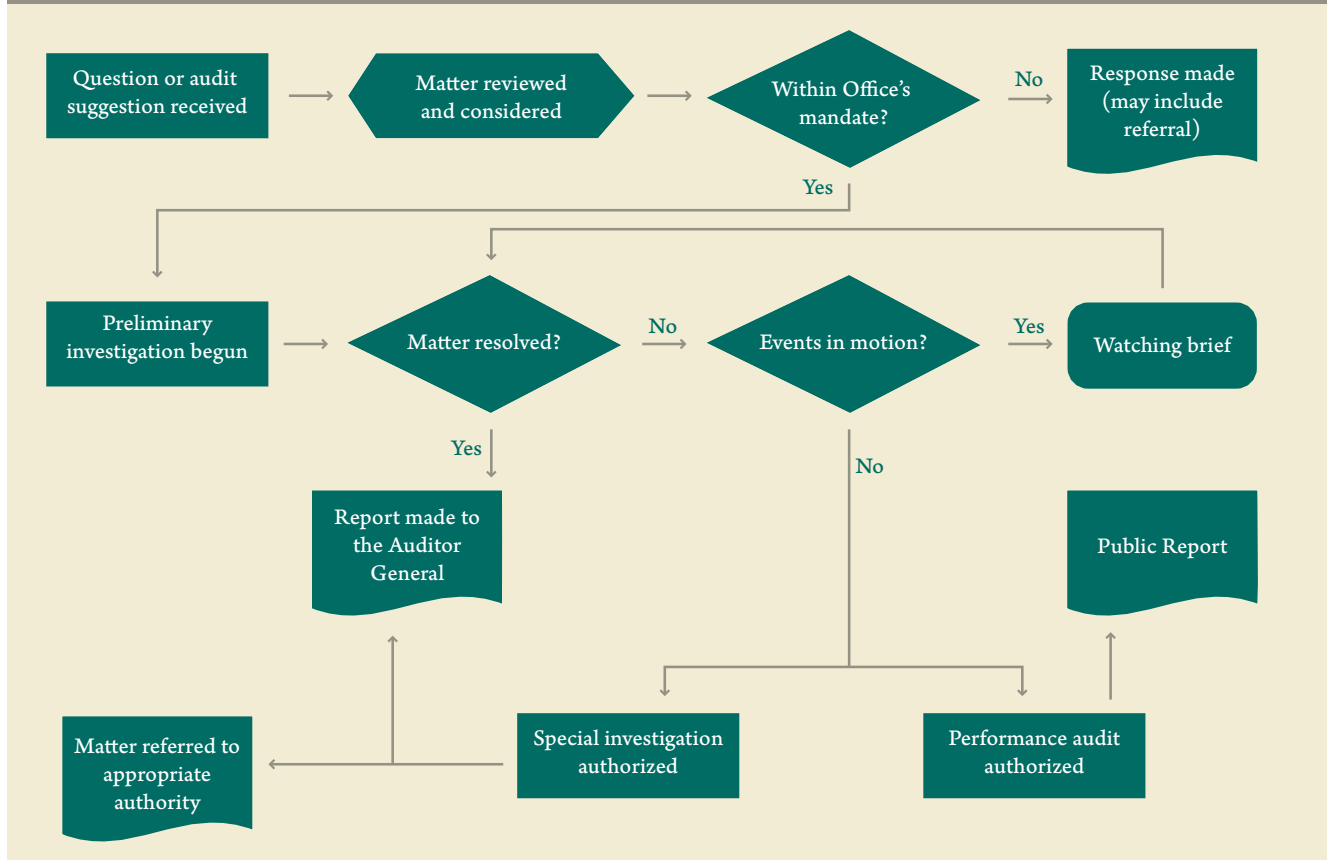
Often people simply need to be put in touch with the right organization, such as another Office of the Legislature (for example, the Ombudsperson) or the government ministry responsible for the subject area. For queries that lie outside the Auditor General's mandate (such as those that come under the jurisdiction of the federal government or a municipality), we direct people to a contact we think is appropriate based on the information we have been provided.

We never forward information provided to us by a person or organization without first receiving the consent of that originating party.

An overview of the investigations process is shown in Exhibit 1.



**Exhibit 1:** Overview of the Office’s investigations process



Where a question or audit suggestion does fall within the Auditor General’s mandate (as described in section 13 of the Act) and appears reasonable to pursue further, the Office begins a preliminary inquiry. This can entail reviewing publicly available information as well as information we already have from other audit work or from limited inquiries we make directly to government ministries or organizations.

These enquiries will either resolve the matter or suggest that more work is necessary. Resolution can include determining that the matter was the result of a misunderstanding, or that it lacked substance. In cases where a matter is before the courts or is already being investigated internally – that is, “events are in motion” – our investigators must hold back. In these situations, our staff may build a “watching brief,” not doing more work on the case but monitoring events as they unfold.



If no events are in motion, the Auditor General may authorize a special investigation or a performance audit.

- ◆ **Special investigations** – Special investigations involve gathering evidence on a narrow subject to determine whether allegations of impropriety can be supported. Results of special investigations are reported to the Auditor General. The investigators will recommend either that no further work be undertaken or that, where appropriate, the matter be referred to the appropriate authority.
- ◆ **Performance audits** – Sometimes an investigation is like pulling a thread: what begins to unravel suggests the matter under investigation is part of a larger concern. Where the results of an initial investigation suggest the existence of systemic, underlying issues, an audit proposal may be developed for inclusion in our normal performance audit program.

## Accountability is to the Legislature

Investigations generate a body of audit evidence from which we draw findings and conclusions. It is up to the Auditor General to decide from these whether the matter should be formally reported to the Legislative Assembly. Because the Auditor General is accountable solely to the Legislative Assembly, the Office does not share any information gathered during an investigation with the person or organization that raised the concern with us. We consider this work to be important to the public and to the Legislative Assembly, in so far as a significant proportion of requests have come from MLAs from all parties. Consequently, the Office will continue to invest resources in this work.

## FINDINGS

A number of investigations were begun in 2012. Two significant investigations we conducted during the year are summarized below:

### Ministry of Health

In March 2012, the Auditor General was anonymously notified about a range of alleged activities within the Pharmaceutical Services Division of the Ministry of Health. The information raised questions about compliance with legal and government policy requirements, as well as with good contracting practices. The Auditor General authorized an initial investigation to validate basic facts and determine whether further work was warranted.

During these inquiries, the ministry was made aware of the concerns that had been brought to our attention. When the whistleblower(s) subsequently came forward (voluntarily), the Auditor General required the party to provide information, in keeping with section 16 of the *Auditor General Act*.

The Ministry of Health then committed to undertaking an internal review of the matter, and the Auditor General began building a watching brief. Results of the internal review resulted in a variety of staffing and administrative actions that have been widely reported in the media.

At the time we were writing this summary, the internal investigation was continuing, as was our Office's work on the watching brief. We will assess the ministry's response and determine at a future date what further actions may be necessary.

## "Organization A"

In July 2012, the Office was contacted by a number of employees of a public body we had audited before. The employees asked for assurance that we would keep their identities confidential – something we are already bound to do under the confidentiality provisions of the *Auditor General Act*.

During interviews we conducted with each complainant, the employees disclosed their concerns about the organization's reaction to recommendations contained in our audit report. As part of the regular audit follow-up process we have since done, we used the information and material provided to us by the complainants to assess the validity of the organization's representations.

## LOOKING AHEAD

In many investigations that come to us, like the two above, the individuals disclosing information are employed by the organization they want us to look into.

We point out that while our audit process offers whistleblowers anonymity, it does not prevent them facing potential reprisals should those individuals be identified inside their organization.

We see the need to protect whistleblowers, and the lack of protection currently provided concerns us.

## PROJECT TEAM

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## BACKGROUND

In 2005, in response to criticisms of how complaints about municipal police forces were managed, the Province of British Columbia asked Justice Josiah Wood to undertake a comprehensive review of the police complaint process.

Justice Wood's review resulted in 91 recommendations for change. The government adopted most of these in 2010 when it amended the *Police Act* (the Act).

Among the amendments was a requirement for a special committee of the Legislative Assembly to follow up on the police complaint process within three years. Section 51.2(2) of the Act says:

“Before January 1, 2013, the special committee must conduct an audit respecting the outcome or resolution of randomly selected complaints and investigations under Part 11, and must submit a report respecting the results of the audit to the Legislative Assembly within one year after the date.”

## PURPOSE AND SCOPE

In response to a request by the Special Committee to Inquire into the Use of Conducted Energy Weapons and to Audit Selected Police Complaints (the Special Committee), the Auditor General agreed to conduct an audit to determine whether the outcome or resolution of randomly selected complaints and investigations were, in all significant respects, completed in compliance with Part 11 of the Act. Part 11 is overseen by the Police Complaint Commissioner.

## FINDINGS

The Auditor General will provide an audit opinion, addressed to the Chair of the Special Committee, asserting that in the Auditor General's opinion, the Police Complaint Commissioner's management and oversight of complaints and investigations complied in all significant respects with Part 11 of the *Police Act*.

## PROJECT TEAM

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## BACKGROUND

**THE PROVINCIAL GOVERNMENT** collects about \$40 billion a year in taxes and other revenues. In turn, it uses these revenues to provide services to British Columbians through various government and quasi- government organizations.

All of these organizations are required to account for the funding they receive through two key documents:

- ◆ an annual update of the organization's *three-year service plan*, mapping out what the organization expects to do in the coming year and hopes to do in the following two years; and
- ◆ an *annual service plan report* (annual report, for short) that discusses the organization's performance relative to its plan for that year.

The annual reports have the capacity to be a key accountability tool for government because they require each organization to describe what it spent as well as what it achieved with that spending. Furthermore, because these reports are designed for a public readership, they can tell an easily understood story that enables readers to evaluate an organization's performance and hold management to account for its successes and failures.

## DEVELOPMENT OF THE BC REPORTING PRINCIPLES

In October 2003, recognizing the importance of the annual service plan reports, government created the [BC Reporting Principles](#) to guide the preparers of those reports in their task (see sidebar). The innovative principles – a joint initiative of the government, legislators and the Office of the Auditor General – were built on the best practices available at that time.

One of the primary purposes of the BC Reporting Principles was to get “*agreement on the fundamentals of meaningful performance reporting*” and to “*support an open and accountable government – one that clearly communicates to the public what government strives to achieve and what it actually achieves*”.<sup>1</sup> The BC Reporting Principles explicitly acknowledged the importance of annual reports to transparent government, noting, “*These performance reports reflect the significant shift that has taken place, to a system that*

<sup>1</sup> Performance Reporting Principles for the British Columbia Public Sector: Principles Endorsed by Government, the Select Standing Committee on Public Accounts and the Auditor General of British Columbia. 2003: page 1.

sets performance measures and targets and holds government agencies accountable for the results achieved.”<sup>2</sup>

The almost 10 years since their publication has meant there are opportunities to update certain aspects of the principles. However, they are still highly relevant and they represent one of the few complete frameworks available to help a government organization tell a meaningful story about its overall performance in the key areas of interest to its stakeholders.

## Our past work in supporting the BC Reporting Principles

The Office has been tracking and supporting the transparency of government performance reporting through a variety of initiatives:

**Building Better Reports** – We first started a systematic assessment of the quality of government organizations’ annual reports with our *Building Better Reports* series (BBR). We published the first report in the series in November 2001, even before the principles were adopted by government in October 2003. We continued the series for five years.

In our [final report in that series](#) (published in March 2006), we noted that after an initial few years of improvements, government’s adoption of the BC Reporting Principles had stalled. None of the organizations we examined had fully incorporated all of the principles we considered in our assessment.<sup>3</sup>

However, we also found that the annual reports of Crown corporations better reflected the principles than the ministry annual reports did. Four of the six Crown corporation reports we examined that year met the “fully incorporated” or “fundamentals in place” level for most of the principles examined, but only five of the 14 ministry reports in our assessment had met the “fundamentals in place” level for any of the principles examined.

**Trends and Opportunities report** – We revisited the importance of public performance reporting in our April 2008 [Strengthening Accountability in British Columbia: Trends and Opportunities in Performance Reporting](#) report, issued two years after our final report in the *Building Better Reports* series. In the document, we reiterated the importance of the BC Reporting Principles, but also noted how the annual reports of most ministries continued to fall short of the standard envisioned in the principles.

**Key Performance Indicator Relevancy Guide** – In December 2010, we issued a guide to help government organizations [develop relevant key performance indicators](#). While this has been a highly visited report on our website since its publication, it does not appear to have resulted in an overall improvement in the annual service plan reports being produced by government.

<sup>2</sup> Ibid.

<sup>3</sup> None of the BC Reporting Principles assessments described in this report included an evaluation of the accuracy attribute of principle 7.

## The value of the BC Reporting Principles

The BC Reporting Principles provide a solid foundation to support government transparency. They go beyond the traditional financial report that focuses on how much money was spent and require the reporting organization to clearly describe what it actually achieved with those funds.

Furthermore, by providing a common reporting framework for all government organizations, the BC Reporting Principles make performance comparisons among those organizations easier to do and more meaningful.

Additionally, when fully implemented, the BC Reporting Principles can provide a framework to support good management. The principles are founded on organizations having identified their mission, their goals and the key aspects of performance they will use to assess their success. Under the principles, these organizations then develop a set of key performance indicators and targets to measure, track and report their performance. This conscious task of identifying, measuring and tracking achievement of results helps ensure that organizations constantly work towards the public purpose for which they were created.

The eight BC Reporting Principles are:

1. Explain the public purpose served
2. Link goals and results
3. Focus on the few, critical aspects of performance
4. Relate results to risk and capacity
5. Link resources, strategies and results
6. Provide comparative information
7. Present credible information, fairly interpreted
8. Disclose the basis for key reporting judgements

## PURPOSE AND SCOPE

In 2012, we evaluated the 2010/11 annual reports of 28 government organizations, along with the guidance provided to those organizations for preparing the reports, against the BC Reporting Principles.

Our sample included 17 ministries, 9 Crown corporations, the Premier's office, and the Province.

## FINDINGS

Our examination showed that little has changed since we last looked at these reports. Once again, none of the reports we examined met all of the BC Reporting Principles.

Crown corporation annual reports were, as before, notably more consistent with the principles than ministry annual reports were. Most of the Crown corporation reports we examined met most of the principles, while most of the ministry reports did not.

This outcome reflected the nature of the annual report guidance provided to the different organizations for this period. That is, compared with the guidance given to ministries, the guidance provided to Crown corporations was far more consistent with the BC Reporting Principles and helped those organizations map out a comprehensive picture of performance that was more in line with the scope called for by the principles.

## OVERALL CONCLUSIONS

We concluded that government-wide adoption of the BC Reporting Principles is still stalled. As a result, the full potential of these reports to enhance government's transparency and accountability to its stakeholders is not being achieved.

## LOOKING AHEAD

In 2013, the BC Reporting Principles will have been around for 10 years. The Office may mark this anniversary by undertaking a more in-depth review of government accountability reporting.

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## BACKGROUND

**PUBLIC TRANSIT** is an integral part of the transportation network in many communities across British Columbia. When people choose public transportation over using a vehicle for their travel, transit services can provide a range of benefits, from reduced road congestion to lower greenhouse gas emissions, and improved community quality of life.

Expanding public transit is a key strategy in the provincial government's Climate Action agenda. In 2008, the Office of the Premier and the Ministry of Transportation and Infrastructure released the Provincial Transit Plan, a strategy aimed at substantially expanding public transit province-wide by the end of 2020.

The plan set significant goals for BC Transit (and TransLink): to double ridership and increase transit market share across the province by 2020 in order to achieve a 4.7-million-tonne reduction in greenhouse gas emissions.

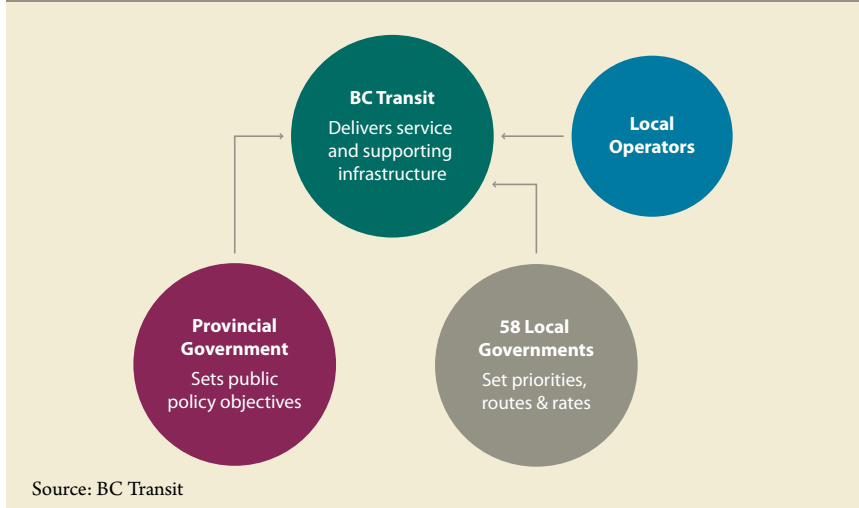
BC Transit is responsible for transit in all areas of the province outside of Greater Vancouver (TransLink is responsible for transit in Greater Vancouver). BC Transit operates 81 transit systems that serve 130 communities, in partnership with 58 local governments. In 2011/12, BC Transit reported that it provided transit services to 1.5 million people in British Columbia, delivering 51.6 million passenger trips.

BC Transit operates within a shared services governance model that involves the provincial government, BC Transit, local governments and local transit operators (Exhibits 1 and 2). Under this governance structure, BC Transit has an influence, but not direct control, over some of the key decisions that affect ridership in transit systems. Achieving the scale of transit growth and transformation in travel habits identified in the government's Provincial Transit Plan requires clarity and close cooperation across the organizations responsible for achieving these goals, the reliable measurement of progress, and the ability to take effective action when results are not achieved.





**Exhibit 1:** BC Transit's shared services governance model



Source: BC Transit

**Exhibit 2:** Responsibilities of each party involved in BC Transit's shared services governance

### Ministry of Transportation and Infrastructure

- ◆ Sets legislative, regulatory and public policy frameworks in which BC Transit operates.
- ◆ Issues performance expectations and reviews these annually.
- ◆ Monitors achievement of goals, objectives, performance and financial targets, and conducts risk assessment of service plans.
- ◆ Provides provincial share of funding for transit services (operations and capital funds).
- ◆ Approves and implements transit funding strategies, such as fuel tax and commercial ventures.
- ◆ Provides direction and support to BC Transit in achieving the public transportation sector's contribution to the Province's greenhouse gas emission reduction targets.

| BC Transit  | Local Governments and Victoria Regional Transit Commission  | Transit systems operational management/Transit management companies<br><small>(includes 20 private and 15 non-profit agencies and 4 local governments)</small>                             |
|---|---|--|
| Oversees regional transit systems: <ul style="list-style-type: none"> <li>◆ Allocates provincial funding for service hours to transit systems.</li> <li>◆ Develops plans for transit services.</li> <li>◆ Carries out marketing.</li> <li>◆ Handles fleet management.</li> <li>◆ Handles contract administration.</li> <li>◆ Operates conventional transit system in Victoria.</li> </ul> | <ul style="list-style-type: none"> <li>◆ Provide operating and capital funding according to the formula in the <i>British Columbia Transit Act</i> regulations.</li> <li>◆ Approve service levels (i.e. number of hours of bus service and when/where those hours will be allocated).</li> <li>◆ Approve fare levels.</li> <li>◆ Maintain transit facilities (e.g. bus stops, exchanges and shelters).</li> </ul> | <ul style="list-style-type: none"> <li>◆ Operate services.</li> <li>◆ Hire and train bus drivers.</li> <li>◆ Provide front-line customer service.</li> <li>◆ Maintain vehicles.</li> </ul> |

Source: BC Transit



## PURPOSE AND SCOPE

As we were finalizing the purpose and objectives of our initial audit plan, the Ministry of Transportation and Infrastructure announced that an independent review of BC Transit's governance and performance would be undertaken. We therefore narrowed the scope of our audit to minimize overlap with that work.

Our audit focused on BC Transit's achievement of ridership growth since the launch of the Provincial Transit Plan. We chose to audit ridership because this is currently the main measure that BC Transit and the ministry are using to determine the success of the plan.

Our objective was to determine whether BC Transit has met its ridership targets (to fulfill the goals of the Provincial Transit Plan) through the implementation of its growth strategy.

## OVERALL CONCLUSION

We concluded that BC Transit is not on track to meet the government's 2020 ridership targets.

- ◆ Actual ridership grew by 6.9 million passenger trips from 2007/08 to 2011/12. However, this is 27 percent lower than what BC Transit projected was needed by then to meet the 2020 target.
- ◆ BC Transit can demonstrate that its growth strategies contributed to ridership increases in some communities, but in other communities it does not have enough evidence to show this.

## KEY FINDINGS

### Ridership growth has fallen short of targets

We found that from 2007/08 to 2011/12, ridership increased by 6.9 million passenger trips compared with BC Transit's target of 9.4 million, which is 27 percent lower than what BC Transit projected was needed by 2011/12 to meet the 2020 target.

According to BC Transit's forecasts, this gap between projected and actual passenger trips will increase to 46 percent by 2014/15.

This means that an increase of 9.2 percent each year between 2015 and 2020 would be required to meet the 2020 ridership targets, almost double the original target BC Transit set for growth (5 percent a year – see Exhibit 3.)

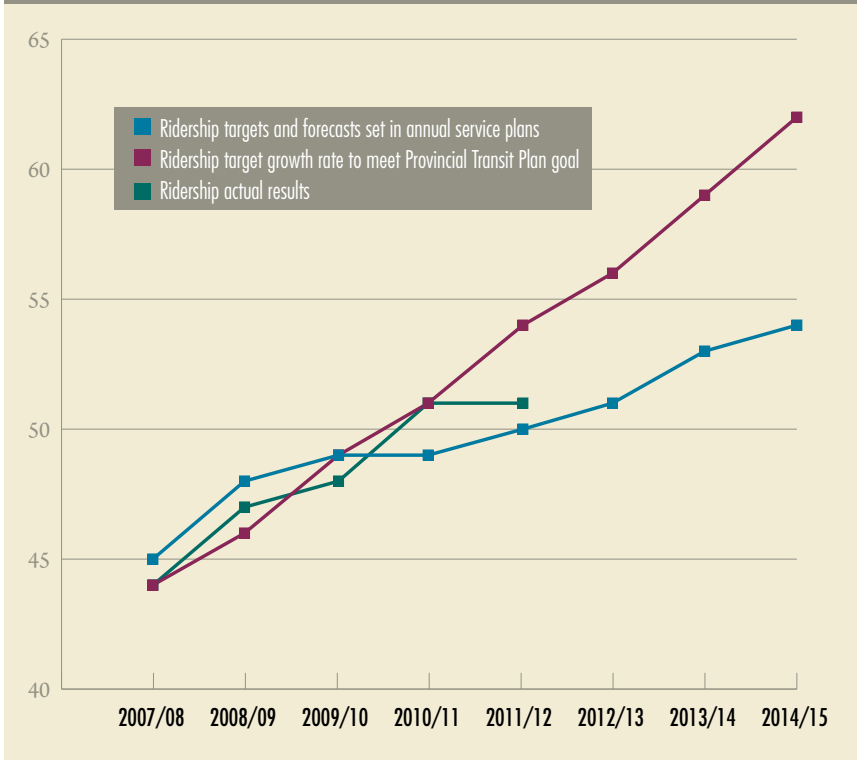
The BC Transit Independent Review Panel was established in March 2012 to review BC Transit's:

- ◆ operations and performance
- ◆ governance
- ◆ communications and consultation
- ◆ funding relationship with local governments

In August 2012, the independent review panel released its report, [Modernizing the Partnership](#). The report included 18 recommendations grouped into three categories: governance, decision making and accountability. Government has responded publicly to the report with a plan for next steps related to the 18 recommendations.

**Note:** The Office recently examined board governance structures and practices in a number of Crown agencies, including BC Transit. Our findings are published in the May 2012 report, [Crown Agency Board Governance](#), which also contains recommendations for both BC Transit and the ministry.

**Exhibit 3:** BC Transit's ridership targets, forecasts and actual ridership results



## Clear targets and collaboration are lacking

Targets help an organization see when its activities are not achieving the results expected, determine why that has occurred and understand how to revise its strategy to improve the chances of reaching the desired results.

We found the Ministry of Transportation and Infrastructure has not provided BC Transit with clear performance expectations for meeting the goals of the Provincial Transit Plan. Neither is the ministry's monitoring of progress consistent with the intent of the plan.

We also found that insufficient collaboration between BC Transit and the ministry has resulted in a lack of understanding about what BC Transit is expected to do to achieve the plan's goals. For example, the ministry developed a model to support the targets set in the plan, but did not share it with BC Transit. BC Transit developed its own model, but the ministry has not reviewed it.

## Performance measurement needs improvement

A range of initiatives aimed at increasing ridership in various communities has been implemented by BC Transit over the past four years, in partnership with the ministry and local governments.

In some systems, we found that BC Transit was able to show that it had accomplished ridership gains through actions it took in keeping with its growth strategy. In other systems, however, we noted gaps in the evaluation and measurement of the impact of initiatives at both the transit system and organization-wide levels. This lack of formal evaluation leaves BC Transit short of the kind of information that would be valuable in guiding and supporting decisions about future initiatives. As a result, and in the context of its governance structure, BC Transit appears to have limited ability to implement or adjust the strategies required to meet yearly growth targets.

In addition, we found that while BC Transit's ridership data is reliable enough to demonstrate growth trends at a province-wide level, it is not of sufficient quality to meet all of its information needs at the system or route levels.

## RECOMMENDATIONS

**WE RECOMMEND** that BC Transit and the Ministry of Transportation and Infrastructure:

- ♦ *revisit the growth strategy, targets and timelines that support achievement of the long-term goals set in the Provincial Transit Plan.*

**WE RECOMMEND** that the Ministry of Transportation and Infrastructure:

- ♦ *clarify the annual and long-term results it expects BC Transit to achieve under the Provincial Transit Plan; and*
- ♦ *develop a performance measurement framework with which to monitor transit effectiveness relative to the Provincial Transit Plan's goals.*

**WE RECOMMEND** that BC Transit:

- ♦ *improve and document its analysis and evaluation of the effectiveness of the initiatives implemented to achieve ridership growth; and*
- ♦ *correct weaknesses in its ridership data to ensure the quality of the data is adequate for the uses intended.*

We have provided BC Transit and the Ministry of Transportation and Infrastructure with further findings and information stemming from our audit, including having brought to their attention a ridership growth success story from Freiburg, Germany.<sup>1</sup>

## AUDIT TEAM

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<sup>1</sup> Buehler, Ralph and Pucher, John. 2011. "Sustainable Transport in Freiburg: Lessons from Germany's Environmental Capital," *International Journal of Sustainable Transportation*, Vol. 5, 43-70.

## BACKGROUND

In 2002, when the *School Act* was amended to provide for school district involvement in entrepreneurial activities, School District No. 40 (New Westminster) was one of the first to set up a business company. School District No. 40 (New Westminster) Business Company (or SD40BC) is incorporated under the *Business Corporations Act* and provides:

- ♦ offshore school programs, through its school Canadian Secondary Wenzhou in China;
- ♦ offshore English language training programs and education; and
- ♦ education and training for teachers and education administrators working offshore.

The corporation was created with the intention of earning profits with which to subsidize the school district's educational programs. After being established, SD40BC needed to borrow just over \$1 million from the school district before it became profitable in its 2007/08 fiscal year (the year ending June 30, 2008). Since then, annual profits have increased and, as of June 30, 2012, the loan balance has been repaid.

Although several school districts now also have business companies pursuing international opportunities, SD40BC was the first to develop a significant offshore operation. For the fiscal year ended June 30, 2012, SD40BC reported having earned revenues of about \$2.1 million.

The school district is governed by an elected board of education. A separate board of directors is appointed and delegated responsibility for overseeing the operations of SD40BC. Matters resulting in public scrutiny have typically related to two questions:

- ♦ What role should the school district board play in the oversight of its business company?
- ♦ What information should SD40BC be expected to provide to the board of education and the public?

Underlying these questions is the public's expectation that school boards be open and transparent – more open and transparent than is typically expected of a profit-oriented company, which has commercial interests to protect.



## PURPOSE AND SCOPE

In the spring of 2011, our Office performed an examination of governance, financial processes and legislative compliance with respect to SD40BC. We initiated this work in response to contact from concerned citizens and our own monitoring of media coverage.

At the end of our examination, we wrote detailed reports with recommendations to both the board of directors of SD40BC (report issued October 2011) and the school district's board of education (report issued January 2012). In February 2012, the board of education published our report to them along with its responses to our recommendations.

We examined SD40BC's board governance, internal controls over key financial processes, and compliance with applicable legislation. We also examined the board of education's governance role in relation to SD40BC. We assessed the design and existence of expected key controls, but did not test whether these controls were working as intended. Our examination did not constitute a forensic investigation and was not intended to identify all material errors or fraud.

Here we summarize the key findings and recommendations we reported to the board of education in January 2012, and include the board's own assessment (updated in November 2012) of its progress in acting on our recommendations. This summary does not present all matters we separately reported to SD40BC's board of directors.

## OBSERVATIONS AND RECOMMENDATIONS

### **Governance relationship with SD40BC**

During our examination, we observed that the governance relationship between the board of education and the SD40BC board was not functioning well.

Views differed among the board of education's trustees on what oversight of SD40BC should involve. Some trustees believed they should have access to more information about SD40BC. Others believed that oversight of SD40BC must be limited in order to protect the board of education from potential liabilities associated with SD40BC operations.

During our examination, SD40BC's directors expressed reluctance about providing additional information to the board of education, citing concerns that the confidentiality of information would not be protected and could result in damage to SD40BC's commercial interests.

In our view, each board has a separate and distinct oversight responsibility with respect to SD40BC. As oversight of the operations of SD40BC has been delegated to the SD40BC Board, it would be inappropriate for the board of education to also

become involved in operational oversight. However, the board of education still has an important governance responsibility – namely, monitoring whether SD40BC's objectives are being met and risks are being appropriately managed.

Because SD40BC exists to benefit the school district and is publicly associated with it, risks to SD40BC (particularly reputation-related risks) are also risks to the school district. The board of education therefore has a responsibility to ensure these risks are well managed, and should monitor and evaluate performance and risk information to the extent required to fulfill this responsibility. During our examination, we found that the information being received by the board of education was not sufficient to satisfy this responsibility.

The two parties need to negotiate through discussion how their respective governance responsibilities should be achieved. Once that is clear, the board of education should then receive only information appropriate to its governance role and none that would result in an operational level of involvement.

As well, the board of education must provide assurance that it will protect the confidentiality of all information it receives and manage its public relations in a way that avoids causing any damage to SD40BC's interests.

**WE RECOMMEND** *that the board of education work with the SD40BC board to establish an appropriate governance relationship, such that each board can more effectively meet its respective responsibilities.*

## Agency relationship risk

If not carefully managed, the nature of the relationship between the board of education and SD40BC could expose the board of education to SD40BC's legal risks, despite the business operations being carried out in a separate corporation.

This is a significant risk, yet it is not being formally monitored by either the school district or SD40BC.

A corporation is a separate legal person with separate rights and duties distinct from those who own the corporation's shares. However, sometimes the courts will disregard the separate personality of the corporation and deal instead with those behind it, with the potential result of the shareholder being held liable for the actions and obligations of the corporation. When this happens, it is known as "piercing the corporate veil."

One reason courts have historically given for piercing the corporate veil is an agency relationship between the shareholder and the corporation. An agency relationship exists when one party represents another in a legal relationship.

The factors we observed that increase the risk associated with a perceived agency relationship pertain to the interrelation of operations and decision making between the two organizations. Potential areas of risk noted include, but are not limited to, the following:



- ♦ the composition of the SD40BC board of directors;
- ♦ lack of proper documentation of decision making by the SD40BC board of directors;
- ♦ monies loaned and advanced by the school district to SD40BC at below-market interest rates; and
- ♦ operational interrelationships between the school district and SD40BC.

**WE RECOMMEND** *that the board of education work with SD40BC to formally assess the risk of the two organizations being in a perceived agency relationship, and then develop, implement and monitor appropriate mitigation strategies to manage the risks identified.*

## Appointment of SD40BC board members

The board of education should oversee the SD40BC director appointment process to the extent appropriate to fulfill its governance responsibilities. Section 122(1) of the *Business Corporations Act* requires that directors be elected or appointed in accordance with the Act and with the Memorandum of Articles of the company.

The Memorandum of Articles for SD40BC requires that at each annual general meeting (AGM) all the SD40BC board members retire and new directors be appointed by a vote of all the board of education members.

During our examination, we noted that in 2010 the SD40BC board was formally appointed at the AGM by the Chair of the board of education. Not all board of education members had input into this appointment process. We also found no record in the previous year's AGM minutes of how members had been appointed.

Furthermore, we noted that the SD40BC board is structured such that the CEO also serves as the board chair. In our view, this arrangement does not facilitate a strong board that would hold management accountable through its independent oversight.

**WE RECOMMEND** *that the board of education, with the input of all trustees, appoint the SD40BC board of directors, as prescribed in the Memorandum of Articles.*

**WE RECOMMEND** *that the board of education oversee the appointment process to the extent necessary to ensure that board members appointed have both the required skills and the objectivity to hold management accountable for performance.*

## Risk of conflict of interest

Since SD40BC was set up, board of education trustees have served on the corporation's board of directors. During our examination, we noted that one board of education trustee – who was also the Chair of the SD40BC board and CEO of SD40BC – may have had an undeclared indirect pecuniary interest, as defined in section 56 of the

*School Act*. During the period we examined, we also noted that this condition may have existed for another former SD40BC director as well.

While section 59 of the *School Act* provides certain exceptions to the conflict of interest rules, these exceptions did not appear to apply in these cases.

We found that these trustees had voted on SD40BC-related matters at board of education meetings, including resolutions to clarify the original terms of the loan and to advance funds to SD40BC. The *School Act* legislation around pecuniary interest states that if a trustee has any pecuniary interest in *any* matter and is present at a meeting of the board of education at which such a matter is considered, the trustee:

- ◆ must disclose the general nature of the interest;
- ◆ must not take part in the discussion of, or vote on, any questions in respect of the matter; and
- ◆ must not attempt in any way to influence the voting on any question in respect of the matter.

Given that members of the board of education are involved in other businesses, and that business interests change over time, it is important for senior management and board members to: understand what a conflict of interest is, declare immediately if they are in a conflict; and declare annually, in writing, their independence and their interests in other businesses so that any actual or perceived conflicts can be noted.

**WE RECOMMEND** *that the board of education establish and implement policies for ensuring its trustees comply with conflict of interest legislation.*

## LOOKING AHEAD

We will continue monitoring the school board's progress in addressing our recommendations. As well, we will continue to monitor issues and risks across the school district sector to inform future governance work by our Office.

## SUMMARY OF KEY RECOMMENDATIONS

We recommended that the board of education:

1. work with the SD40BC board to establish an appropriate governance relationship, such that each board can more effectively meet its respective responsibilities.
2. work with SD40BC to formally assess the risk of the two organizations being in a perceived agency relationship, and then develop, implement and monitor appropriate mitigation strategies to manage the risks identified.



3. with the input of all trustees, appoint the SD40BC board of directors, as prescribed in the Memorandum of Articles.
4. oversee the appointment process to the extent necessary to ensure that board members appointed have both the required skills and the objectivity to hold management accountable for performance.
5. establish and implement policies for ensuring its trustees comply with conflict of interest legislation.

## Board of Education Self Assessment [November 2012]

### *Preamble*

In September, 2012, the board of education and SD40BC developed a Memorandum of Understanding (MOU) that describes activities and responsibilities to be undertaken by each entity as they relate to: a) governance relationship, b) agency relationship risk, c) appointment of SD40BC board members, and d) risk of conflict of interest. Responses to the recommendations as described below are drawn primarily from the MOU with respect to the four key areas.

### **Governance Relationship with SD40BC**

#### *Response*

In September, and prior to its Annual General Meeting, SD40BC will provide the following to the board of education on an annual basis: a) a summary report on the previous year's activities, b) audited financial statements for the past school year, c) a preliminary budget for the next school year, d) an outline of next year's Business Plan, and e) an outline of the Risk Assessment Management Plan. Furthermore, in February and July of each year, SD40BC will provide summary information to update the board of education on progress made with regard to its annual plan.

In addition, the board of education will not request nor receive information that would result in an operational level of involvement and will take all necessary measures to protect the confidentiality of information received.

### **Agency Relationship Risk**

#### *Response*

As agreed to in the MOU, SD40BC will ensure that board activities are regularly, accurately, and thoroughly recorded. The SD40BC will also ensure clarity of understanding respecting the overlap of personnel between the two entities whenever such overlap might occur to reduce the risk of a perceived agency relationship. SD40BC will also manage its activities, goals, business plan, risk assessment plan, and conflict of interest policy on an ongoing basis.

With the exception of the appointment of either the secretary treasurer or a trustee under the *School Act*, the board of education will ensure that appointment of all remaining board members of SD40BC is in compliance with Section 95.4 (2.1) of the *School Act*. Further, any monies loaned to SD40BC by the board of education will be at a rate reflective of fair market value. The board of education will also promote the understanding that it is not involved in the operations of SD40BC when participating in activities of SD40BC.

## Appointment of SD40BC Board Members

### Response

The SD40BC will ensure that activities at its Annual General Meeting are consistent with the Memorandum of Articles for SD40BC. All SD40BC board members will retire at its AGM, and the entire board of education will appoint all SD40BC board members at the AGM.

In preparation for the AGM, SD40BC will select and recommend new SD40BC board members, and will ensure that the recommended members possess the required skills and appropriate objectivity to hold management accountable for performance.

## Risk of Conflict of Interest

### Response

SD40BC will ensure that any pecuniary interest be declared in situations that may arise from time to time with respect to SD40BC business activities. Further, SD40BC will ensure that its activities are in compliance with Board of Education policy as well as its own policy as it relates to conflict of interest.

At present, the board of education and SD40BC each has its own policy relating to conflict of interest. The board of education has a trustee code of ethics policy which contains a comprehensive section on the topic of conflict of interest, while SD40BC has a code of ethics policy which was developed in spring, 2012. A joint conflict of interest policy is currently under development and should be completed in spring, 2013.

With respect to the matter of any future loans being provided to SD40BC by the board of education, a thorough review of any potential or perceived conflict of interest will be undertaken prior to any funds being provided to SD40BC.

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