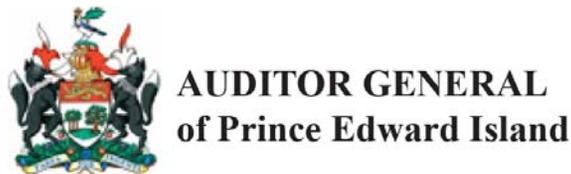


Atlantic Canada's Auditors General Joint Audit **Atlantic Lottery Corporation**

October 2016



Introduction – Joint Audit

- Atlantic Lottery Corporation (ALC) is an example of the four Atlantic Provinces working together.
- Each government (NB, NL, NS & PEI) is a shareholder
- Joint audit with other Atlantic Canada Auditors General
- Last performance audit of ALC by Auditors General was in 1996



Presentation Topics



2016 Volume II Report contains:

- Chapter 1 - Introduction
- Chapter 2 - Corporate Governance
- Chapter 3 - Compensation and Benefits
 - Travel, Hospitality, and Board Expenses
 - Contract Management
 - Procurement of Services



Atlantic Lottery Corporation

- Crown corporation founded in 1976
- Returned over \$1.8 billion in profit to Atlantic Provinces in last 5 years
- 600 employees across the Atlantic Provinces
- Headquarters located in Moncton, NB
- Overseen by a Board of Directors



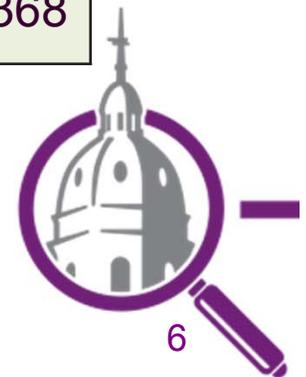
Gaming Environment

- Gaming environment is evolving rapidly
- ALC's operations have expanded to include VLTs (video lottery terminals), online sports betting and a casino in PEI
- ALC is facing significant market changes



Annual Revenue and Profits (\$ millions)

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





Atlantic Lottery Corporation

Chapter 2: Corporate Governance

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ALC - Corporate Governance

What is governance?

- Structures and processes for overseeing the direction and management of a corporation
- These components assist in carrying out mandate and objectives effectively



ALC - Corporate Governance

What are elements of a sound governance system?

- Clarity of objectives and expectations
- Clear lines of accountability
- Transparency



ALC - Corporate Governance

- Effective Crown agency governance requires a balanced framework.



ALC - Corporate Governance

Our objective was to:

- Determine whether ALC's governance structures and processes create a framework for effective governance and are working well



Strong Board Practices

ALC Board adopted governance best practices and is improving.

Best practices include:

- Board evaluations and member peer assessments
- Orientation for new members
- Use of sub-committees including audit committee
- Governance and policy manual



Summary of Findings

- ALC's governance framework is insufficient to deal with its strategic challenges
- Mandate is not clear
- Board composition is challenging effective operations of ALC
- Unclear Board authority
- Timely info not provided to Board for effective decision making
- Weaknesses in accountability framework
- Government intervention causes inefficiencies
- Reporting improvements needed



ALC's governance framework is insufficient to deal with its strategic challenges

Improvements to the governance framework are necessary for ALC to:

- function effectively and efficiently in maximizing shareholder governments' returns;
- ensure it knows and respects its operating limits; and
- avoid potential loss of market relevance



Mandate is Not Clear

ALC's complex mandate comes from multiple sources including:

- 4 sets of provincial gaming legislation
- 3 provincial gaming strategies (NB, NS, PEI)
- The Unanimous Shareholder Agreement
- ALC agency agreement with NSPLCC
- Mandate Letter (signed by NB, NL, PEI)
- ALC mandate statement in its annual report



Recommendation

We recommend the shareholder governments 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.



Board composition is challenging effective operations of ALC

- Dual role (public servant & director) may hinder governance effectiveness
- Potential conflict due to divided loyalties
- Examples:
 - By-law changes regarding director appointment process
 - Pension plan funding deficit



Recommendations

- Board members should not be elected officials nor employees of Government
- Shareholder governments should change the role of public servants on ALC Board to non-voting...in accordance with best practice.
- **Response:** “*Disagree*”...”*Shareholders believe that it is in their best interests to continue to have a government representative at the board.*”



Unclear Board Authority

- Confusion around ALC's decision-making authority as roles and responsibilities of ALC and governments are not defined
 - Unanimous Shareholder Agreement amendments
 - Three legal opinions obtained for guidance



Timely Info. Not Provided to Board for Effective Decision Making

- ALC Board approved a strategy calling for nontraditional growth, mobile gaming and expansion outside Atlantic Canada.
- Strategic initiatives not supported by governments

Example: Internet gaming initiative

- \$640,000 lost after governments did not support Board decision



Investment in Geonomics



- Investment involved a start-up UK company and a new online lottery called GeoSweep
- In 2011, ALC board authorized the \$8 million investment as it supported multiple aspects of the corporate strategic plan
- Only PEI & NB participated in the investment
- Entire value of investment written off in 2015
- Loss absorbed by NB & PEI governments



Investment in Geonomics

The ALC Board failed to:

- Consider risks and tolerance of governments, the impact on ALC's reputation and ability to pursue future ventures
- Conduct its own independent due diligence work



Investment in Geonomics

Management did not fully disclose all relevant information and risks to the Board such as:

- high risk nature of investing in a tech. start-up;
- Roboreus' impending cash shortage;
- business plan assumptions were considered optimistic; and
- untested nature of the game and daily draw structure.



Recommendations

Overall, we recommended the Board should:

- ensure risks are thoroughly assessed for future initiatives; and
 - obtain all info. required for this assessment
- ALC agreed with our recommendations
 - We found the Board better exercised their oversight on subsequent major initiatives



Weaknesses in Accountability Framework

- Lack of defined roles and responsibilities
- Governments failing to provide clear and timely performance expectations
- Public reporting on performance not meeting recommended practices



Government Intervention Causes Inefficiencies

- Unclear accountability allows for disruptive government intervention

Techlink Example:

- NS ordered ALC to override business processes and advance \$1.26 million to Techlink
- Directive was carried out against the recommendations of ALC and the Board



Reporting Improvements Needed

- Improvement needed in ALC’s annual performance reports to show progress made

Atlantic Lottery Corporation – 5 year net profit and growth trend

Fiscal Year	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Net Profit (\$million)	\$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 YoY%						-1.1%



Recommendations

We recommend shareholder governments:

- Should routinely collaborate and give ALC regular and timely policy direction.
- Define and document their roles, responsibilities and authorities for oversight of ALC.
- Define formal performance expectations for ALC that are clear and publicly communicated.



Audit Findings - Governance

- Governance framework insufficient to deal with strategic challenges
- Governments have not provided ALC with:
 - Clear direction and performance expectations
 - Parameters within which to make autonomous decisions
 - Clearly defined roles and responsibilities
- We made eight recommendations to shareholder governments, five to ALC Board





Atlantic Lottery Corporation

- Chapter 3:**
- Compensation and Benefits
 - Travel, Hospitality, and Board Expenses
 - Contract Management
 - Procurement of Services

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Our objectives:

To determine if the following are appropriately managed in an efficient and economical manner:

- Compensation and benefits;
- Travel, hospitality and board expenses,
- Significant contracts; and,
- Procurement of services



What Worked Well

- Purchasing of services is meeting their policies and working well
- Contracts have terms to protect ALC and are regularly monitored



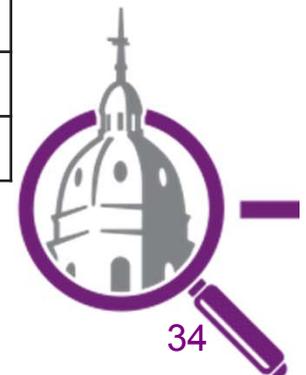
Summary of Findings

- Significant increases to executive compensation without shareholder consultation
- Lack of public disclosure of salaries
- ALC's travel, hospitality and board expenses are not managed with consideration for economy and transparency
- Pensions funding shortfall



Executive Compensation Review

	Prior to Compensation Review (2013-14)	Subsequent to Compensation Review (2014-15)	% change
Chief Executive Officer (CEO)			
Base salary	\$255,502	\$255,502	0%
Maximum annual bonus	\$43,350	\$66,300	53%
Total	\$298,350	\$321,300	8%
Chief Operating Officer (COO) and Chief Financial Officer (CFO)			
Base salary (High Range)	\$199,800	\$278,000	39%
Maximum annual bonus	\$19,980	\$63,940	220%
Total (High Range)	\$219,978	\$341,940	56%
Vice President			
Base salary (maximum)	\$173,160	\$204,000	18%
Maximum annual bonus	\$17,316	\$28,560	65%
Total (maximum)	\$190,476	\$232,560	22%



Annual Public Sector Salary Increases

	2013-14	2014-15	2015-16
New Brunswick	0%	0%	1.0%
Newfoundland and Labrador	\$1,400 signing bonus No increase in salary	2.0%	3.0%
Nova Scotia	2.5%	3.0%	0%
Prince Edward Island	0.5%	1.5%	1.5%

We recommend ALC should:

Get direction from governments on ALC's approach to its compensation packages, to determine if aligned with shareholder expectations



Public Compensation Disclosure

- ALC does not provide detailed compensation disclosure

We recommend ALC should:

Disclose compensation info. and consult shareholder governments on their expectations for this disclosure.



Pension-Deficit Funding

- ALC employees participate in the Council of Atlantic Premiers defined benefit pension plan.
- \$79 million solvency shortfall

Annual Pension Deficit Funding, 2013–2019 (millions)

	ALC Total	NB	NL	NS	PEI
Total Repayment	\$78.7	\$20.9	\$20.6	\$26.6	\$10.6
Annual Amount	\$14.0	\$3.7	\$3.6	\$4.8	\$1.9



Travel, Hospitality & Board Expenses



- In files we tested, 92% were noncompliant with at least one requirement of the policy
- ALC's policy does not identify when alcohol might be an appropriate expense
- Some expenses were not properly approved, missing receipts and/or lacked documented explanations



Recommendation

We recommend ALC 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.





Stakeholder Relations Spending

Approx. \$73,000 claimed for tickets to various events used for stakeholder relations :

- \$14,000 for 125 tickets to the 2014 Cavendish Beach Music Festival over and above tickets received as an event sponsor
- \$48,000 for 300 tickets to the 2015 AC/DC concert in Moncton, in which 26 tickets were given to gov. officials

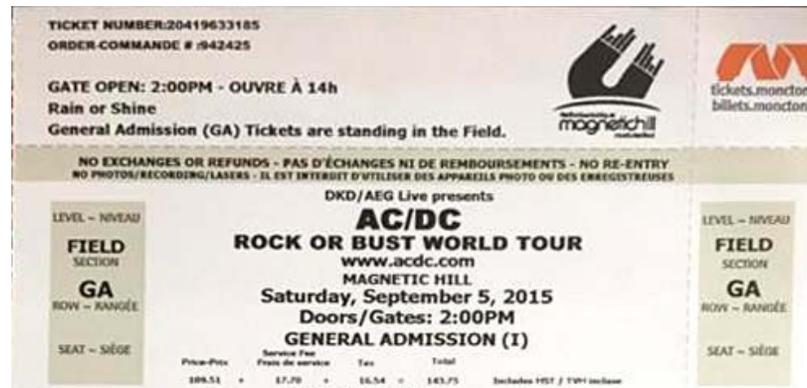
These expenditures by ALC do not demonstrate an appropriate use of shareholder money.



Recommendation

We recommend ALC should:

- Not buy event and concert tickets to give to government and elected officials in an effort to simply improve shareholder relations.



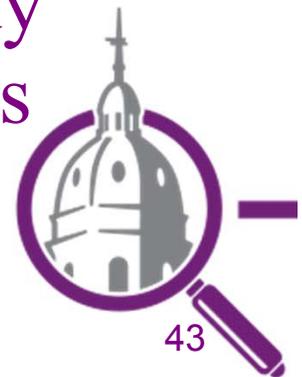
Chapter Highlights

- Significant pay increases for executives without consulting shareholder governments
- Travel, hospitality, and board expenses not well-managed
- 12 recommendations in this chapter
- ALC has now started to post salaries on their website



Overall Highlights

- ALC is a good Atlantic initiative
- We hope this report and our 25 recommendations will encourage necessary changes to ALC's governance framework and operating practices
- Providing clear performance expectations may also address some of the other problem areas
- We are pleased to see that ALC has already started to implement our recommendations



Questions?

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