Energy Solutions Centre Inc.

February 2005

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the Yukon Legislative Assembly:

I have the honour to transmit herewith my Report on the Energy Solutions Centre Inc. to the Yukon Legislative Assembly in accordance with the provisions of section 35 of the *Yukon Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Vancouver, 7 February 2005

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Energy Solutions Centre Inc.

Main Points

1. Our audit of the financial statements of Energy Solutions Centre Inc. (the Company) for the year ended 31 December 2003 found serious problems in the overall management of the Company. We issued a qualified audit opinion on the Company's financial statements and found other issues we believe merit the attention of the Yukon Legislative Assembly.

2. The audit determined that the Company's governance and oversight process failed. The management did not operate in the full and complete interests of the Company and the board of directors did not exercise sufficient oversight and control to protect the public interest and the funds that it was entrusted with. The board of directors was not informed of many significant management actions. Nor did the board challenge management in order to determine the true state of affairs of the Company, which would have led to action to change the situation.

3. The corporate reporting structure contributed to limited accountability of the Company's board of directors and management. There was no funding agreement between the Company and the Yukon Development Corporation, its parent, and its principal source of funds. Management failed to establish adequate financial systems and internal controls and were responsible for actions that were questionable. The president negotiated and approved contracts for two senior managers that were inappropriate under the circumstances. These contracts were generous and included lengthy notices of termination, regardless of the possible reasons for the termination. We saw no evidence that the board was briefed or consulted on these arrangements.

Background and other observations

4. The Energy Solutions Centre Inc. is a wholly owned subsidiary of Yukon Development Corporation (YDC). It was incorporated by YDC in 2000 under the *Business Corporations Act*. The Yukon Development Corporation is a government corporation—an agent of the Government of Yukon.

5. It was not clear why the Company was established by its parent corporation, and the audit could not determine why the Company was involved in certain activities. These deficiencies have resulted in the Company's operating costs being higher than necessary. We found that most contracts awarded by the Company were not subject to competitive bidding. We also found that management did not submit contracts, projects, and leases to the board of directors for approval as required.

6. We recommend that the Government of Yukon review the Company's structure and objectives to determine the Company's future direction.

7. This report, along with the recommendations of the Standing Committee on Public Accounts, may also be used by the Government of Yukon to examine and, where necessary, re-engineer its relationships with all of its government corporations and their subsidiaries so that these organizations can best serve the public interest in the future.

Introduction

Energy Solutions Centre Inc. and its operations

8. Energy Solutions Centre Inc. (the Company) is a small subsidiary of the Yukon Development Corporation (the Corporation), a government corporation owned by the Government of Yukon. The Company was incorporated in 2000 pursuant to the *Business Corporation Act*. The Government of Yukon appoints the members of the board of directors of the Yukon Development Corporation, who among themselves nominate members to the Energy Solution Centre Inc.'s board of directors. The board of directors is responsible for stewardship of the Company and oversees the president and other senior managers who are responsible for the Company's day-to-day business affairs.

9. The Company operates the Canada Yukon Energy Solutions Centre as a program delivery agency for the federal and Yukon governments. In 2000, the Yukon Development Corporation and Natural Resources Canada entered into a funding agreement pursuant to the Canada-Yukon Letter of Cooperation on Energy Efficiency and Renewable Energy. Under this agreement, the Corporation would provide $578,000 in funding over three years. Natural Resources Canada would provide $175,000 per year from 2000 to 2003, and $200,000 annually for 2004 and 2005.

10. The Company's objectives are to promote, co-ordinate, and facilitate energy programs and projects with an overall goal to create energy cost savings and reduce greenhouse gas emissions. The Company relies upon private and public sector interaction to identify projects and initiatives. It engages technical consultants and contractors to provide technical and program services on a project-specific basis.

11. From 2001 to 2003, the general manager and chief executive officer of the Corporation was also the Company's president. In addition to the president, the Company had two employees that had been seconded from the Government of Yukon. The Company also retained under contract a professional corporation and an individual to carry out the functions of the managing director and the treasurer respectively. The Yukon Energy Corporation, the other subsidiary of the Yukon Development Corporation, processes all invoices and payments on behalf of the Company.

12. In 2003, the Company's key activities included managing the Whitehorse General Hospital boiler installation and the Haines Junction Aquifer projects and conducting energy audits. The centre was also involved in activities related to a number of climate-change-action fund agreements.

13. In May 2003, the Government of Yukon appointed a new chair to the board of directors of the Yukon Development Corporation, who also became the new chair of the Yukon Energy Corporation's board of directors. He later became chair of the Company in August 2003. In November 2003, he revoked the signing authorities of the president and the managing director.

The chair also invoked the termination clauses in the contracts for the managing director and the treasurer. The president was later transferred to a department of the Government of Yukon.

Focus of the audit

14. We audited the financial statements of the Energy Solutions Centre Inc. for the year ended 31 December 2003. During the audit, we became aware of serious deficiencies in the overall management and control of the operations of the Company. As a result, we expanded our audit work to look at issues relating to corporate governance, oversight, and control in the Company and its parent, the Yukon Development Corporation. We interviewed staff; reviewed documents; and examined internal controls, funding arrangements, and contracting practices. We also looked at the Company's management of energy audits and major projects.

For more information on our audit, see **About the Audit** at the end of the report.

Observations and Recommendations

Corporate governance and oversight

Lack of oversight and control over the management of the Company

15. Our audit observed examples of significant concern about how this company operated. In particular, we found that oversight and control were not properly exercised. As noted in this report, the management of the Company often did not seek the approval of the board of directors when it should have done so. Conversely, the board did not adequately monitor, question, or follow up matters with management that would have prevented some of the problems that arose. This report illustrates what can happen without sufficient oversight and control over the management of an organization.

16. We feel that the most significant concern relates to a failure of the corporate governance regime. We found significant weaknesses in the structure and operation of this Company's governance.

17. Government corporations are generally established to operate at arm's length from government and provide services in a different manner than operations carried out by government departments. Government corporations are not subject to the same rules as departments and are usually under the guidance and direction of a board of directors. The directors are most often appointed by the Commissioner in Executive Council, and the chair of the board of director's reports to the responsible minister. Periodically, the chair of the board can be called on to appear before the Legislative Assembly's Committee of the Whole to report on corporate activities and answer questions from members of the Legislative Assembly.

18. Government corporations function at a distance from traditional government operations under a distinct accountability framework. Despite these differences, government corporations are still a part of the government program family and are subject to similar fundamental principles of accountability that apply to government departments.

19. Government corporations must act within the terms of their mandate established under a specific statute or provided to it through a policy instrument from the responsible minister. The minister, in turn, is responsible for answering for the activities of the corporation to the Legislative Assembly and for ensuring that the corporation's mandate reflects current government policy. If communications between a government corporation and its minister are poor, the result may be accountability that is severely weakened.

20. The biggest risk to the public is where the directors and managers of a government corporation or its subsidiary feel that they are fully independent of government and can act on their own without being held accountable. Thus, the relationship between a government corporation, including its subsidiaries, and the government has to be subject to clearly understood rules that allow for policy direction and accountability.

21. Apart from requirements in legislation establishing a specific government corporation, the 2003 *Corporate Governance Act*, enacted in 2002, is the only legislation which provides direction on government corporations. Specific requirements for federal Crown corporations are outlined in Part X of the federal *Financial Administration Act*. The territorial act of the same title has no such requirements. The federal requirements include budgeting, corporate planning, reporting and audit, appointment of directors and their duties, and accountability to Parliament.

22. We also note that the Standing Committee on Public Accounts of the Yukon Legislative Assembly held hearings in February 2004 on the governance of government corporations. Its report on the hearings made recommendations on

- reviewing the criteria for appointment to boards of directors;
- reviewing the method of appointment of chairs of the boards and operational heads;
- establishing a standing committee on appointments to major government boards and committees;
- training members of the boards of directors;
- tabling annually in the Legislative Assembly the planning and accountability documents that contain performance measures and expectations;
- making amendments to the Yukon's *Financial Administration Act* to mirror federal legislation;
- establishing a process to evaluate mandates;
- negotiating annually the protocols with ministers and corporations regarding each corporation's performance expectations and the roles of the minister, board, and president in the work of the corporation; and
- being accountable to the members of the Legislative Assembly more frequently.

These recommendations indicate areas where governance of entities such as the Energy Solutions Centre Inc. and the Yukon Development Corporation can be improved. The Legislative Assembly, the Government of Yukon, and government corporations should seriously consider these recommendations.

23. Neither the senior management nor the board of directors of the Company operated in the full and complete interest of the Company and in the public interest. The board of directors was not sufficiently informed of many of management's actions, but we expected more effort from the board to challenge management in order to determine the true state of affairs in the Company, and to take action to change the situation.

24. **Recommendation.** The board of directors and senior management of the Energy Solutions Centre Inc. should ensure that the Company has established sound policies and practices, and provide sufficient oversight and control over the management and operations of the Company. As recommended by the Standing Committee on Public Accounts, the Government of Yukon should examine the legislative framework, governance structure, and accountability relationships for its government corporations and their subsidiaries.

Management's response. As is described in more detail in the management responses to the various recommendations in this report, oversight and control over Energy Solutions Centre has been considerably improved during 2004 and the mandate and operations of the Company have been more strictly defined in the 2005 Business Plan.

Government of Yukon's response. The Government of Yukon is cognizant of the Standing Committee recommendations as they pertain to legislative frameworks, governance structures, and accountability relationships for government corporations and their subsidiaries. The government is currently in the process of reviewing the YDC and Energy Solutions Centre legislative, governance, and accountability relationship (see recommendation 91). The government will also take under advisement the February 2004 Public Account recommendations, as well as the recommendations contained in this report, as they relate to the legislative framework, governance, and accountability structures for other government corporations.

Rationale for the creation of the Company unclear

25. The Company was not established by specific statute; rather it was created pursuant to the *Business Corporations Act*. It was set up by the Yukon Development Corporation (the Corporation) as a subsidiary. Although the Corporation has the authority to establish a subsidiary, we would have expected the Government of Yukon to be informed of the creation of the Company. The Corporation was not directed by the Government of Yukon to set up this entity. Instead, the Company was created without informing the minister why there was a need to have a separate subsidiary company.

26. It is unclear why this company was originally set up. The funding agreement established between Yukon Development Corporation and Natural Resources Canada did not require the Corporation to establish a separate company. Neither the level of funding from Natural Resources Canada nor the length of these agreements required the creation of a separate entity. It does not appear that the costs and benefits of setting up the Company were carefully considered prior to its establishment. While the Corporation's board of directors was informed that the Energy Solutions Centre Inc. would be co-located with the Yukon Development Corporation to share and reduce costs, the findings in this Report would indicate that costs of operating the Company were not insignificant. We note that the *Corporate Governance Act*, which came into effect after the creation of the Company, requires that new government corporations can only be established either through legislation or with the consent of the Commissioner in Executive Council.

Overlapping roles and responsibilities and unclear accountability

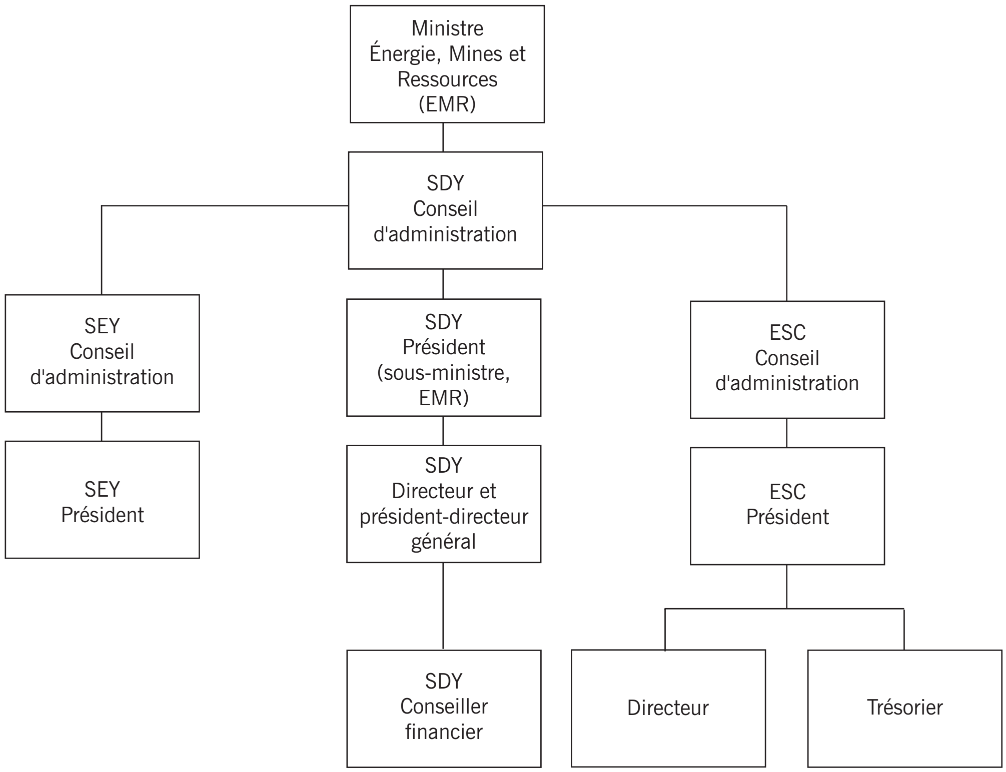
27. Exhibit 1 outlines the corporate reporting structure of the Yukon Development Corporation and its subsidiaries as they existed in 2003. The responsibilities of board members among the various entities overlapped and were not clear. Management responsibilities also overlapped, and some individuals had roles in more than one organization.

28. The board of directors of the Yukon Development Corporation is comprised of the same members as the board of directors of its main subsidiary, the Yukon Energy Corporation (YEC). The *Yukon Development Corporation Act* requires that members of its board of directors be appointed by the Commissioner in Executive Council. The Yukon Development Corporation Regulation requires that members of the Yukon Energy Corporation's board of directors be nominated by the minister and that certain activities of Yukon Energy Corporation require approval of the Yukon Development Corporation's board of directors and the minister. By statute, both corporations are subject to audit by the Auditor General. The Yukon Energy Corporation is also answerable to its ratepayers through the *Public Utilities Act* and has further responsibilities under the *Waters Act*.

29. However, Energy Solutions Centre. Inc. was not established by a separate act and as a result, it has much less accountability than its related corporations. Although the Company is owned by the Yukon Development Corporation, it is not clear whether it is considered a "wholly-owned subsidiary" as defined in the *Corporate Governance Act*. The Company's board of directors is accountable only to the Yukon Development Corporation's board of directors and not to the minister. However, most of the members of the Company's board of directors are from the board of its parent corporation. Unlike its parent or the Yukon Energy Corporation, the members of the Company's board of directors are nominated by the Yukon Development Corporation's board. In addition, the Company's president also sat on the board of directors. We also noted that unlike its affiliated corporations, the Company's board of directors had no audit committee.

30. The general manager and chief executive officer of the Yukon Development Corporation was also the president of the Energy Solutions Centre Inc. This overlap made it difficult to determine the role this individual was carrying out and for which organization.

Exhibit 1 2003 reporting structure of Yukon Development Corporation (YDC), Yukon Energy Corporation (YEC), and Energy Solutions Centre Inc. (ESC)



Notes:

1. Number of Board Members – YDC 7
   – YEC 7
   – ESC 4
2. The Yukon Government appoints Board members of YDC and nominates same to the YEC Board.
3. The YDC Board appoints Board members of ESC.
4. Members of the ESC Board are also members of the YDC Board.
5. The Chair of the YDC, who was appointed in May 2003, also became the Chair of YEC, and in August 2003 became the new Chair of the ESC.
6. The YDC General Manager and Chief Executive Officer was also the President of ESC.
7. The YDC Financial Advisor is also the Treasurer of ESC.

Corporate Management

Large management contracts not authorized by the board of directors

31. The Company filled both the managing director's and the treasurer's positions through contracts for services. However, it is not standard practice for government entities to fill management positions through such contracts. Contracts for services are generally used as a temporary measure for specific services and should not be used for management positions that require the incumbent to make decisions, sign contracts, authorize payments, or exercise control in an organization. The contracts with these two managers did not follow these principles. We also found the payments made under them to be generous, considering the duties required.

32. Based on our review of these contracts, the Company's personnel costs have been higher than necessary. For instance, the managing director had billed the Company a total of $370,127 for his professional services and expenses for the period from November 2001 to December 2003. For the year ended 31 December 2003, he was paid over $168,000, which was more than any employee of the Government of Yukon. He was also reimbursed for over $12,000 in expenses for that year. This is more worrisome in light of the fact that the managing director position reported to the president of the Company, a small subsidiary of a government corporation. When the termination clause in the managing director's contract was triggered, it required that he be given a year's notice. We found that one year's notice of termination was too lengthy for such a contract, in light of the fact that it was to be given regardless of the reason for the contract being terminated.

33. We observed that the managing director's and treasurer's contracts were signed by the president, but the amount of the managing director's contract exceeded the president's signing authority. The board of directors was not presented with the contracts, was not informed of their specifics, and did not ratify the contracts.

34. The treasurer's contract was not as lucrative, but it was also not based on an analysis of the work required for such a small organization. For the year ended 31 December 2003, the treasurer was paid $103,838, plus expenses of $739. In addition, he had a contract with the Yukon Development Corporation as a financial and business management consultant under which he was paid a further $37,600. This means his total earnings for 2003 from these companies was $141,438. His contract with the Company also included a six-month termination clause, which was less than the managing director's; however it still raises the same concerns.

35. **Recommendation.** The Energy Solutions Centre Inc. should limit the use of contracts for services for management positions. The board of directors should establish a corporate remuneration policy that includes senior managers. The board should also scrutinize and approve larger contracts to ensure that terms and conditions, including termination clauses, are reasonable and appropriate before they are signed.

Management's response. The current management and staff of Energy Solutions Centre consist of an employee and two employees seconded from Yukon Government. Services of a president and a chief financial officer are provided by Yukon Energy on a part-time, cost-recovery basis. The company has also entered into a temporary contract with a consultant (without a termination clause) to fill the position of managing director. The board of directors is aware of this contract. The Company intends to fill this position with an employee in early 2005. All staff positions are now properly classified according to accepted Human Resource practices consistent with Yukon Government systems, and all employees are compensated according to this system.

Questionable treatment of managers as contractors

36. We observed that the expenditures related to the managing director's and treasurer's contracts were classified as consulting fees in the Company's 2001 and 2002 financial statements. However, the application of Canada Revenue Agency guidelines, based on the manner and conditions under which these individuals performed their tasks, would suggest that these managers behaved as employees, rather than as independent contractors.

37. As these positions appeared to be those of employees, but no income tax or other payroll deductions were withheld from their pay, it is possible that the Company may not have followed tax rules properly in treating these managers as contractors. In addition, these individuals may have been able to claim certain business expenses for tax purposes that tax laws do not allow employees to claim. If the Canada Revenue Agency investigates and finds these individuals to be employees, the employer, Energy Solutions Centre Inc., would have to pay the employer and employee contributions for both employment insurance and the Canada Pension Plan. Furthermore, the Company may also be charged penalties and interest for failing to deduct and remit income tax in respect of amounts paid. At the conclusion of our audit, the Company had acknowledged the problem but had yet to act on the matter.

38. Consultants are usually hired because they have skills and abilities that existing staff do not have. We observed that some consultants were sent on training courses. In some cases, this training was provided outside of the territory.

39. **Recommendation:** The Energy Solutions Centre Inc. should determine if an employer-employee relationship exists with any of its contractors and if so, make the appropriate tax and payroll deductions.

Management's response. The use of contractors in the future will be only for specific projects (or for general management duties on a temporary basis) and Canada Revenue Agency guidelines will be adhered to. With respect to contractors used in the past who may be considered employees, the Company has obtained legal advice. Since it is not possible to determine with precision whether in fact they were independent contractors or employees, the advice is that no steps should taken in respect of those former workers.

Appointment of different auditor

40. Unlike the Yukon Development Corporation and the Yukon Energy Corporation, there is no statutory requirement for the Energy Solutions Centre Inc. to have the Auditor General audit its financial statements.

41. In December 2000, the Yukon Development Corporation's board of directors, acting on behalf of the shareholder of the Company, passed a resolution to appoint the Office of the Auditor General as the auditor of the Energy Solutions Centre Inc. The board of directors of Energy Solutions Centre Inc. passed a resolution in March 2002, recommending that the Yukon Development Corporation revoke this appointment; the board recommended that another auditor based in central British Columbia be appointed the Energy Solutions Centre Inc.'s auditor. The management of Energy Solutions Centre Inc. informed its board of directors that the Auditor General was not in a position to carry out the audit, although there was no basis for this statement. It should be noted, the Auditor General is the auditor of most Yukon government corporations, including the Corporation and its other subsidiary. Management also advised the Company's board that all six local firms declined the audit because they were either too busy or in a conflict of interest situation. Management stated that proposals were solicited from other Canadian firms conducting audits in the Yukon.

42. The recommendation to appoint another auditor was accepted by the Yukon Development Corporation's board of directors, and the auditor from central British Columbia carried out the audits of the Energy Solutions Centre Inc. for the 2001 and 2002 fiscal years. In October 2003, the Energy Solutions Centre Inc.'s board recommended that the Yukon Development Corporation appoint the Auditor General as the auditor of the Energy Solutions Centre Inc. for the 2003 fiscal year.

Qualified auditor's report on the Company's financial statements

43. An audit is carried out on financial statements by an independent auditor to provide assurance to readers that the statements fairly present a company's financial position and results. In some cases, the auditor cannot provide such an opinion and expresses a reservation in his auditor's report. These situations can indicate one or more serious financial shortcomings in a company.

44. In our audit of the Company's 2003 financial statements, we observed that the Company recorded $152,061 in expenses that, in our opinion, did not have sufficient basis for payment. The amount of $102,881 was incurred without adequate evidence that the work was performed. Invoices totalling this amount were paid despite a lack of adequate documentation that services were provided. These invoices were mainly for time charged by consultants on projects that were not supported by details of the dates and times of their work. Also included in the $152,061 was $49,180 in expenses that were outside of the terms and limits set out in contracts with suppliers. We have qualified our opinion on the 2003 financial statements for these transactions. There were also a large number of adjustments, based on the findings from our audit, which management made to the 2003 financial statements of the Company prior to the statements being presented to the board of directors for approval. These included misclassification of government funding as revenue and write-offs of energy audits. These adjustments are indicative of poor financial and accounting controls.

Significant weakness in internal controls

45. Management is responsible for safeguarding the Company's assets and promoting operational efficiency and adherence to prescribed policies. Management is also responsible for establishing and maintaining adequate internal controls.

46. **Lack of segregation of duties.** For 2003, the board of directors approved the Company's signing authorities, stipulating that only the president had signing authority for high-dollar-value expenditures, up to specified limits, on behalf of the Company. The president subsequently delegated the same levels of authority to the managing director.

47. We found that the managing director negotiated, issued, and signed contracts on behalf of the Company and approved payment of many of the related invoices. The managing director also was a signing authority for cheque payments. This practice is contrary to basic internal controls that require appropriate segregation of duties. Normally, an employee who has exercised signing authority for expenditure initiation or certification of performance may not requisition payment for the same transaction. In addition, there was limited secondary review to ensure that the work invoiced had actually been completed according to the terms of contracts. This lack of control exposed the Company to higher risks of error and fraud.

48. We noted that 24 invoices for expenses and time billed submitted in 2003 by the managing director, amounting to approximately $52,501, were approved either by himself or by an individual who did not have delegated signing authority to approve them. We also observed that the managing director approved an invoice for reimbursement of a portion of his spouse's travel expense when she accompanied him on a trip.

49. **Recommendation.** The Energy Solutions Centre Inc. should strengthen its system of internal controls to safeguard the Company's assets and promote operational efficiency and adherence to prescribed polices. This includes segregation of duties and compliance with delegated signing authorities. Management should ensure that services invoiced by contractors have been carried out in accordance with contract terms and conditions.

Management's response. Internal controls have been strengthened considerably. As noted in paragraph 13, the Company's chair revoked the signing authorities of the president and managing director in November 2003 and, effective January 2004, was appointed the chief executive officer. Expenditures in 2004 were approved for payment by the CEO following a review (evidenced by signature) of the services or goods invoiced. The review was predominantly made by the managing director or finance personnel. Payments to contractors are not made unless in accordance with contracts.

Need to establish measurable goals and adhere to approved budget levels

50. **Lack of performance measures**. While the Company's 2002 Annual Report does provide general information about the various programs that it offered, the information provided does not give the reader a clear understanding of the level of activity for its programs; nor does it provide information about how the Company intended to measure its results and to report on its performance. While the Company's goals may be laudable, they need to be established at a level where they can be measured and the actual performance reported on annually. We did not find that this was done.

51. **Budget levels exceeded.** We observed that the Company prepared a budget and a business plan for 2003, which were approved by the Company's board of directors. However, we found the information contained in these documents did not provide the reader with a clear understanding of the nature and extent of the Company's anticipated activities for the year. We also found that a number of expenditure categories exceeded budget limits. One control that could have been used would be to have management obtain approval of the Company's board of directors prior to exceeding previously approved budget limits. We found these over-expenditures were not approved by the board of directors.

52. **Recommendation.** The Energy Solutions Centre Inc. should establish goals that are measurable. The Company should establish key performance indicators to measure and report how effectively and efficiently each objective is met. The Company should be adhere to approved budgets and ensure that expenditures in excess of authorized budgets are approved by the board of directors.

Management's response. The 2005 Business Plan which was presented to the board and approved in December 2004 is significantly clearer regarding the Company's proposed expenditures and funding sources. If expenditures are forecasted to be in excess of the budget, board approval will be obtained prior to committing the costs.

Most contracts awarded without competition

53. The Company established contracting guidelines, but they specifically excluded employment contracts and subcontracts already in place with contractors relating to projects the Company funded. No explanation was provided to us as to why these types of contracts were excluded from the contracting guidelines.

54. We observed that the Company granted only a few contracts on a competitive bid basis. Of the 15 contracts entered into in 2003 for a value of $25,000 or greater, only 3 were tendered. When contracts are offered to only one party, this is referred to as sole-sourcing. Sole-sourcing for services makes it difficult to ensure that the Company is receiving good value, whereas the competitive bidding process provides some assurance that a better value will emerge from among the bids submitted by choosing the best combination of value and price. Sole-sourcing also denies other companies the opportunity to secure government contracts, which is contrary to the principle of open access to government business. Open access provides all qualifying vendors a fair chance to do business with the Company without political or bureaucratic favour.

55. We observed that one contractor, Duncan's Limited, had significant business dealings with Energy Solutions Centre Inc. through a number of sole-sourced contracts. In 2003, three contracts were awarded to Duncan's Ltd. worth a combined value of $66,359. Two other contracts were awarded to Duncan's Ltd. before 2003 that were also sole-sourced.

56. Two of the five contracts were for the installation of a solar panel ($6,298) and a solar water monitoring system ($56,923) on a building owned by Nacnud Holdings Ltd., a company that is related to Duncan's Ltd. We were advised that these expenditures were for research and development purposes. These amounts were subsequently billed to the Yukon Development Corporation, which then charged these expenditures to the Green Power Fund that is discussed later in this Report.

57. Another contract ($1,615) was for the installation of equipment to monitor the heating and cooling systems at the personal residence of the president of Duncan's Ltd. in order to conduct an energy analysis. A contract ($5,060) was also entered into with a consulting firm to monitor the systems at the residence, collect raw data, and present quarterly reports for one year. The Company also paid to purchase the equipment for this project ($6,953). These contracts raise serious questions regarding the use of public funds, as there does not appear to be much benefit to the Company.

58. In three cases in 2002 and 2003, the Energy Solutions Centre also paid for equipment that was purchased and installed by Duncan's Ltd. Energy Solutions Centre Inc. then leased the equipment to the companies occupying or owning three different buildings. In two of the cases, the equipment was installed in buildings owned by Nacnud Holdings Ltd. The other case involved a building owned by Duncan's Holdings Ltd., a company related to Duncan's Ltd. This building is the site of Duncan's Ltd. and all of its related companies. One of the other buildings houses Energy Solutions Centre Inc. and the Yukon Development Corporation. There were two other cases where Duncan's Ltd. purchased and installed equipment on other companies' premises and were paid by the Energy Solutions Centre Inc. The payments for the purchase and installation activities totalled $171,801. The invoices sent to the Energy Solutions Centre Inc. lacked detail, no supporting documentation was attached, and there was no independent certification of the work being completed prior to the Company making payment.

59. The building space occupied by both the Yukon Development Corporation and the Energy Solutions Centre Inc. is leased by the Government of Yukon from Nacnud Holdings Ltd. We also found that additional rental space was leased in the building without any documented requirement for such space. The space remained vacant for a considerable time before being subleased. Although in the past, there had been an agreement between the Corporation and the Government of Yukon for leased space, no such agreement was in place for the additional space rented.

60. **Recommendation.** The Energy Solutions Centre Inc. should establish sound contracting policies and procedures to provide for transparency and competition and to ensure best value and open access to its business. The Company should ensure that all transactions are properly documented, clearly relate to its corporate activities, and contribute value to the Company.

Management's response. Management agrees that contracting at Energy Solutions Centre should provide for transparency, competition, and best value. New contracting policies and procedures have recently been implemented at Yukon Energy and, where appropriate, these will be adapted for use at ESC. With respect to the additional rental space, this is now being leased by a Yukon Government department.

Lack of funding agreement with Yukon Development Corporation

61. In 2001 and 2002, the financial statements showed profits of $78,508 and $59,430, respectively. However, in 2003, the Statement of Operations and Retained Earnings were reclassified to reflect the fact that government funding is no longer considered to be revenue. The financial statements now clearly disclose the Company's economic reliance and dependence on government funding, particularly funding from the Yukon Development Corporation.

62. Although the majority of the Company's funding for operations is provided by its parent, the Yukon Development Corporation, there is no written funding agreement in place between the Corporation and the Company. In 2003, total funding from the Yukon Development Corporation was $1,708,372, of which $195,312 was reported as funding from the agreement between the Corporation and Natural Resources Canada. Without a formal funding agreement between the Company and its parent, it is not apparent how much funding the Corporation is willing to provide, for what purposes, and how it expects the Company to account for the use of this funding. These expectations are identified in the agreement that the Corporation has with Natural Resources Canada.

63. The 2003 Business Plan of the Yukon Development Corporation discloses a $3,246,000 cash outflow as part of a long-term investment in Energy Solutions Centre Inc. This amount is not broken down between loans and operating financing and does not agree to the Energy Solutions Centre's Inc.'s Business Plan. The Company's 2003 Business Plan has revenue for program delivery budgeted at $1,213,000. Defining funding arrangements is of particular concern as the overlap in the roles of board members between the two entities has meant that the accountability for providing the funding and the accounting for its use are unclear.

64. **Recommendation.** The Energy Solutions Centre Inc. should ensure that a funding agreement between Yukon Development Corporation and the Company is in place in order to clarify what the level of funding is to be provided, what the funding is intended for, and how the spending of these funds is to be accounted for.

Management's response. Management concurs that a funding agreement between YDC and the Company will be developed early in 2005. ESC's 2005 Business Plan was developed in conjunction with YDC, such that the funding arrangements are consistent between the two entities.

Lack of policy guidelines and criteria on how Green Power Funds are to be used

65. **The Green Power Fund.** Of the $1,708,372 in funding from Yukon Development Corporation in 2003, $535,399 represents funding from the Green Power Fund. The Green Power Fund is a 10-year initiative funded with an initial endowment of $3 million from the Government of Yukon, which was transferred to, and is managed by, the Yukon Development Corporation. The goals of the Green Power Fund program were to increase the production and sale of small-scale renewable energy projects to meet the electrical-service requirements of Yukon communities and industry and to reduce greenhouse gas emissions. The Fund was set up for private interests to access; but most of the funds distributed have been to the Company. This creates the perception of a conflict of interest that should have been addressed by an open and rigorous process to decide how to distribute the funds. However, we found that the Yukon Development Corporation had no formal policy guidelines or criteria for the distribution of monies in the Green Power Fund.

66. It is unclear how projects receiving Green Power funding were selected. We observed that the Energy Solutions Centre Inc.'s 2003 Business Plan only anticipated $100,000 as a source of cash from the Green Power Fund. The additional $435,399 funding from the Green Power Fund was not approved by the Yukon Development Corporation's Board of Directors. It does not appear that there was sufficient review by the Corporation of the Company's billings for Green Power funding.

67. **Recommendation.** The Yukon Development Corporation should, in consultation with the Government of Yukon, develop policy guidelines and criteria on how Green Power Funds are to be used.

Management's response. Management agrees with this recommendation. The use of Green Power Funds will be reviewed and polices developed during 2005.

Need for the Renewable Power Sales Incentive Program Operating Agreement not clear

68. The purpose of the Renewable Power Sales Incentive Program was to provide financial incentives to customers to install secondary electrical-power infrastructure in existing and new facilities through arrangements that would be mutually beneficial to the consumer, Yukon Energy Corporation, and the ratepayers as a whole. Savings would flow to customers through the use of lower-cost, renewable, electricity generated during periods of hydro surplus on Yukon Energy Corporation's power systems. This Agreement between the Yukon Development Corporation and the Company expired on 31 March 2003 and has not been renewed at this time.

69. The operating agreement identified the role of the Company as providing technical services to facilitate energy solutions for consumers and to improve the delivery and effectiveness of federal and territorial energy programs. The operating agreement provides a listing of responsibilities for the Company and for the Yukon Development Corporation. The agreement states that the Yukon Development Corporation agrees to make financial contributions to a

Renewable Power Sales Incentive Program Fund accessible to the Yukon Energy Corporation and the Energy Solutions Centre Inc. to a maximum of $1,000,000 in 2001, and $500,000 in each of the years 2002 to 2004. The Agreement also provides necessary loan financing for projects subject to approval of annual business plans. No fund was ever established, and no contributions were ever made by the Yukon Development Corporation.

70. **Recommendation.** The Energy Solutions Centre Inc. should clarify with the Yukon Development Corporation the need to renew the Renewable Power Sales Incentive Program operating agreement and to establish the related Fund.

Management's response. Financial incentives are no longer provided to customers to install secondary electrical power infrastructure. The provision of secondary power sales is now solely the responsibility of Yukon Energy Corporation.

Need to establish policy guidelines and signing authority to enter into lease agreements

71. The guidelines for the Renewable Power Sales Incentive Program Operating Agreement state that non-government customers are expected to provide or obtain financing through financial institutions. The agreement specifies that loans to non-government customers would be considered where there is a requirement and a very low risk, and where the administrative costs can be justified. The agreement also specifies that the loans would be subject to maximums established by the Yukon Development Corporation from time to time.

72. We observed that the Energy Solutions Centre financed several projects under the program by way of lease—having equipment purchased and installed at a customer's premises and then leasing it to the customer. This was done despite the fact that the Company's board had not delegated any signing authority for lease agreements to management, and there was no provision in the operating agreement for the Company to enter into any lease agreements. We reviewed documentation for a lease finalized in 2003 and observed that at the time the lease was signed, the lessee was a high credit risk and therefore the lessee fell outside of the criteria established in the operating agreement outlined in the above paragraph.

73. **Recommendation.** The Energy Solutions Centre Inc. should establish policy guidelines and signing authority to enter into lease arrangements. Should the Renewable Power Sales Incentive Program operating agreement be renewed, the Company should work with the Yukon Development Corporation to clarify the roles and responsibilities of the two organizations and ensure that program criteria are adhered to.

Management's response. No new lease arrangements are being entered into by the Energy Solutions Centre. One remaining lease being finalized in 2005 was established in October 2003.

Management of energy audits and major projects

Need to establish criteria for energy audits

74. We found that the Company's practice of carrying out energy audits exposed it to unnecessary financial risk. The Company engaged consultants to carry out energy audits for buildings owned by third parties. The energy audits result in reports that provide information related to costs and benefits of potential energy-efficiency changes to the buildings. One example of such a change would be heating installations to displace fossil-fuel heating processes. If a third party decides to go ahead with the energy projects, the project costs would include the cost of the energy audits. However there is no obligation for third parties to go ahead with an energy projects after an energy audit is completed; nor is there a cost borne by the third party for the energy audit, should it decide not to proceed with the energy-efficiency project.

75. It is not clear why certain energy audits were completed. For example, the Company arranged for an energy audit that was completed in December 2003, for a warehouse building that had been vacant since 1990. This building was in poor condition from an architectural viewpoint. For example, its roof panels were 25 years old, and daylight could be seen through various parts of the roof. The energy audit concluded that an upgrade of $1,317,000 would be required, which seemed unlikely to occur, given that the owner did not have immediate plans to use the warehouse.

76. The costs related to the energy audits are included in the Company's work-in-progress accounts. On occasion, management would write off the cost of the energy audits if it determined that it was unlikely that the third parties would proceed with energy projects recommended in energy audits. We reviewed the work-in-progress account balance at the end of 2003 and recommended that a write-off of approximately $96,000 was required because the related energy projects were unlikely to proceed. The management of the Company agreed with this finding and made this write-off accordingly.

77. **Recommendation.** The Energy Solutions Centre Inc. should develop criteria for energy audits to be carried out to ensure that energy audits are justified and the need is properly documented. It should also consider the recovery of all or a part of the cost of such audits.

Management's response. The 2005 Business Plan for Energy Solutions Centre, as approved by the Company's board of directors, does not budget for general energy audits. Instead, a portion of the time of the company's Energy Efficiency Advisor has been budgeted to "promote, supervise and help make funding applications for energy audits including municipal audits."

Lack of board approval in undertaking the Yukon Hospital Corporation project

78. This project relates to the design, installation, and operation of a hot-water building-heating system and a domestic hot-water-heating infrastructure at the Whitehorse General Hospital. The project was carried out to obtain benefits from excess or secondary power that may be available from the Yukon Energy Corporation.

79. The Company entered into four contracts related to the project:

- the purchase of the boiler,
- the installation of the boiler,
- the management of the project, and
- the upgrade of the electrical infrastructure that serves the hospital. The company was subsequently reimbursed for the costs by the Yukon Energy Corporation.

80. Due to the anticipated, large size of this project, estimated at $712,000, we expected that the Company's board of directors would have approved the project's financing before the start of the project. Neither the Board of Directors of the Energy Solutions Centre Inc., nor the Board of Directors of the Yukon Development Corporation specifically approved this project. The loan to the Hospital is recorded on the financial statements of the Yukon Development Corporation.

81. A letter dated 17 May 2002 from the Minister of Health and Social Services to the Acting Chair of the Board of Trustees, Yukon Hospital Corporation, provided the necessary approval for the Hospital to borrow the funds from the Energy Solutions Centre Inc. The Company issued a letter to the Yukon Hospital Corporation for the equipment loan. We noted that the letter was signed by the managing director of the Company but he was not delegated the authority to lend money by the Company's board of directors.

82. **Recommendation.** The Energy Solutions Centre Inc. should ensure that project financing for major projects is approved by the Company's board of directors prior to the start of the project. In addition, it should ensure that loans are made only by officials with the appropriate delegated authority.

Management's response. No financing for any project is budgeted for 2005. The financing for any future projects will be approved by the Company's board of directors prior to the start of the project.

Lack of a business case for the Haines Junction Aquifer project prior to implementation

83. Prior to commencing a larger project, we would expect a business case be prepared to support the project and be reviewed and approved by the board of directors; the Company should clearly identify financing, and it should be in place before the project starts. This was not done for the Haines Junction Aquifer project. In January 2003, the Company and the Village of Haines Junction signed a joint venture agreement to form an unincorporated joint venture to carry out a project in which the parties would participate equally. The project consisted of assessing the technical and financial feasibility of exploiting heat from the aquifer. Under the agreement, the Energy Solutions Centre Inc. was designated as the manager for the project.

84. The joint venture agreement stated that the Company would help the Village of Haines Junction prepare and follow up applications to third-party agencies that may provide grant funding or non-repayable contributions to the Village for the initial phase of the project. Any grants or contributions that the Village obtained would be provided to the Company; it would be deemed as the Village's contribution to the joint venture. The Company would then make contributions to the joint venture equal to the contributions made by the Village up to a maximum of $100,000. The joint venture agreement also stated that each party would be severally liable for its proportionate share of joint venture liabilities and expenses. In addition the agreement stated that, from time to time at the call of the manager, both parties would pay and contribute in advance their proportioned share of joint venture expenses incurred. The share of each of the parties would vary, from time to time, according to each party's interest.

85. We observed that the Company started the initial phase of the project and incurred all project costs before any grant funding or non-repayable contributions were received. In 2003, the Company incurred costs of $176,631 on the project. All project costs were billed to the Company, which subsequently billed the Green Power Fund of the Yukon Development Corporation for the project costs.

86. The Green Power Fund Implementation Strategy specifies that the research and development component of the Fund includes resource assessments for wind, solar, hydro, and biomass. However, the implementation strategy did not identify assessments for geothermal resources, such as the Haines Junction aquifer, as a category in the research and development component of the Green Power Fund. It is unclear how this category of resource assessment was approved as it appears to be outside of the guidelines of the implementation strategy.

87. We noted that a $246,821 contract was awarded to a consulting firm for this project that was signed by the managing director of the Company. We also found that subsequent to the signing of this contract, a change order agreement for $12,085 was signed. Including this change order, the contract exceeded the managing director's authorized signing limit of $250,000, and therefore the change order agreement should have gone to the Company's board of directors for approval.

88. In early 2004, the consultants completed the business case study for the project. Based on the results of the study, switching all properties in the Village to geothermal heat would necessitate very large capital investments, which would be risky without better information. An analysis of a new geothermal heating system for the town centre buildings only concluded that the payback would be rather long, ranging from 15 to 31 years. The management of the Company reported to its board of directors that there was no economic benefit unless the partners could obtain government funding, in the form of a capital grant. Management agreed to have the consultants analyze other options related to this project. As the project and the consulting contract were not initially approved of by the board of directors, it did not have the opportunity to question management as to the merits of the project. If a preliminary business case been prepared and presented to the board of directors before entering into the contract, the board may have decided not to proceed with the project, and the Company may have avoided the significant expenditures incurred on this project to date.

89. **Recommendation.** The Energy Solutions Centre Inc. should prepare a business case for all major projects for approval by the board of directors. The Company should ensure that external funding and signed agreements with third parties are secured prior to the Company making project expenditures. The Company should obtain approval from Yukon Development Corporation for expenditures to be reimbursed from the Green Power Fund prior to signing joint venture agreements with third parties.

Management's response. Management agrees with this recommendation and has taken steps to ensure that the board of directors are fully informed on all activities of the Company and approves any arrangements with third parties.

Future of the Company

90. The future of the Energy Solutions Centre Inc. is in question. The contribution agreement with Natural Resources Canada for the Efficiency and Alternative Energy Program expires 31 March 2005. The management of the Company is working with this federal department to reach a new agreement. Meanwhile, there have been significant changes to the Company's management. The results of our audit showed that there were significant risks related to the Company's operations. We believe that the Government of Yukon needs to determine the Company's future direction.

91. **Recommendation.** The Government of Yukon should review the Company's mandate, objectives, and corporate governance structure to determine the Company's future direction.

Management's response. The Company's governance structure is currently under review by Government. Any changes to the structure are expected to be put in place in 2005.

Conclusion

92. Throughout the report, we identified significant concerns about how this Company operated. We identified significant weaknesses in the structure and operation of the corporate governance regime. Oversight and control were not properly exercised. Management did not operate in the full and complete interests of the Company, and the board of directors was not informed of many, significant management actions. The board did not exercise sufficient oversight and control to protect the public interest. The rationale for the creation of the Company was unclear, and there were overlapping roles and responsibilities in the corporate structure. In summary, the corporate governance and oversight process failed.

93. Corporate management was weak. We are particularly concerned that the president kept the board of directors uninformed about the details of generous contracts for two managers. We identified significant weaknesses in the Company's internal controls and contracting practices and qualified our auditor's report on the Company's 2003 financial statements. We also observed shortcomings in funding and operating agreements. Management of energy audits and major projects needs to be strengthened.

94. We urge the Government of Yukon to review the Company's mandate, objectives, and governance structure to determine the Company's future direction.

About the Audit

Objectives

Our original objective was to express an opinion on the financial statements of the Energy Solutions Centre Inc. for the year ended 31 March 2003. As a result of concerns about the overall management of the Company, we expanded our audit work to determine the extent to which the Company and its parent, the Yukon Development Corporation, had in place a corporate governance framework to provide oversight and control over the management and operations of the Company.

Scope and approach

The audit flowed from our audit of the Company's 2003 financial statements. We also examined the following areas:

- corporate governance, oversight, and control;
- corporate management including management contracts, internal controls, funding agreements, and contracting practice; and
- management of energy audits and major projects.

We reviewed relevant legislation, the Company's system of internal controls, selected contracts and project files, and funding agreements. We also interviewed Company officials. We did not examine the records of contractors.

Audit criteria

- A corporate governance structure should be in place to provide for oversight and control over the operations of the Company.
- The Company should have a clear mandate, and it should establish goals that are measurable. The Company should establish key performance indicators to measure and report how effectively and efficiently each objective is met.
- The Company should have established sound policies and practices to ensure that its assets are safeguarded and its operations are economical, efficient, and effective.
- The board of directors should periodically review the Company's operations and follow up as appropriate. The Company should adhere to approved budgets and ensure that expenditures in excess of authorized budgets are approved by the board.
- Management positions should be filled by full-time employees.
- There should be an adequate system of internal controls to ensure that delegated responsibilities have been properly discharged and that there is an appropriate segregation of key functions. Authority and responsibilities should be clearly assigned to specific individuals to provide accountability for all actions within the organization.
- Invoices should be in accordance with contract terms and conditions, and work should be carried out before payments are made.
- Contracting practices should be consistent with established policies and procedures. Payments for contracted services should conform to contractual terms and conditions.
- Funding agreements should be established and clearly understood by all parties. Funding should be in place before expenditure commitments are made.
- There should be established criteria for carrying out energy audits. Cost of energy audits should be recovered from third parties.
- The Company should prepare a business case for all major projects for approval by the board of directors.

Audit team

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