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Report of the
**Auditor General
of Canada**
to the House of Commons

NOVEMBER

Chapter 12
Role of Federally Appointed Board Members—
Sustainable Development Technology Canada



Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents is found at the end of this publication.

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Chapter

12

**Role of Federally Appointed Board
Members**

Sustainable Development Technology
Canada

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Role of Federally Appointed Board Members

Sustainable Development Technology Canada

Main Points

What we examined

Sustainable Development Technology Canada (SDTC) is a not-for-profit foundation established by the federal government to support the development and demonstration of technologies related to climate change, clean air, clean soil, and clean water. The government has provided it with \$550 million under three successive funding agreements with Natural Resources Canada and Environment Canada.

In the third funding agreement, signed in March 2005, the government introduced a change that affected the role of those members of the SDTC Board of Directors who were federally appointed. This raised certain concerns about the governance of the Foundation, which we decided to examine.

Why it's important

In a “board-centred” model of governance, the board of directors is responsible for the supervision of the business and affairs of the organization. The government has acknowledged that federally appointed members of the boards of directors of foundations such as SDTC are obliged, like every other board member, to act in the best interests of the organization.

What we found

- Seven of the fifteen members of SDTC’s Board are appointed by the federal government. The government’s change to its funding agreement with the Foundation prevents the Board from making any decisions in a meeting where a majority of members present are government appointees. To resolve this problem, the Board passed a by-law providing for a subsequent vote by the other board members, but directors told us that the process is inefficient and hampers the Board’s ability to operate. Given that the Board generally meets only four times a year, the change in the funding agreement makes it difficult for the Board to govern the Foundation’s affairs.
- The government’s change in the funding agreement interfered with the ability of federally appointed directors to carry out their duties.

The government has responded. Natural Resources Canada and Environment Canada agreed with our recommendation on behalf of the government. They have undertaken consultations with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the SDTC Board.

Introduction

12.1 Sustainable Development Technology Canada (SDTC or the Foundation) is a not-for-profit foundation that has received three grants—for a total of \$550 million—from the federal government to fund its activities. It serves public policy purposes, under legislation and three successive funding agreements with the ministers of the sponsoring departments: Natural Resources Canada and Environment Canada.

12.2 The Foundation was established by the *Canada Foundation for Sustainable Development Technology Act* in June 2001. It finances and supports the development and demonstration of new sustainable development technologies related to climate change, clean air, clean water, and clean soil.

12.3 The Foundation's mission is to act as the primary catalyst in building a sustainable development infrastructure in Canada. To achieve this mission it

- awards funds to develop and demonstrate new sustainable development technologies,
- fosters and encourages collaboration and partnerships among different organizations, and
- ensures timely diffusion of these technologies in relevant market sectors.

12.4 The Foundation was set up to complement the sustainable development activities of a number of government departments.

12.5 The Foundation is governed by a Board of Directors that reflects the broad interests of the public, private, and academic sectors in Canada. The Board of Directors is composed of fifteen individuals:

- seven, including the Chair, who are appointed by the Government of Canada through a Governor in Council appointment; and
- eight, who are appointed by members of the Foundation.

12.6 In the third funding agreement of March 2005 with the Foundation, the Treasury Board Secretariat required the insertion of a clause that prevents the Board from making decisions in a meeting where a majority of directors present are government appointees. The Foundation raised concerns about how the clause will affect Board governance. These concerns led us to undertake the audit.

Focus of the audit

12.7 We examined how the change in the March 2005 funding agreement affected the role of federal appointees to the Board of Directors. Our objective was to determine whether the government’s position on the role of federal appointees to the Foundation’s Board of Directors supported effective board governance.

12.8 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendation

Governance of the Foundation’s affairs

12.9 We expected that the Treasury Board Secretariat would provide guidance to the sponsoring departments, Natural Resources Canada and Environment Canada, that supports good governance; and that the sponsoring departments would follow this guidance and make provisions for good governance arrangements through the funding agreement.

New clause impedes the Board’s operations

12.10 In March 2005, the Treasury Board Secretariat asked officials at the two sponsoring departments, Natural Resources Canada and Environment Canada, to insert the following clause in the revised funding agreement:

The Foundation agrees that the federal government appointees to the Board will not comprise a majority proportion or number required to attain quorum or to effect any decision of the Foundation, the Board, or any committee thereof, or necessary to comply with the by-laws of the Foundation.

12.11 Although the Foundation objected to this clause, the Secretariat insisted that the sponsoring departments insert it as a condition for the Foundation to receive funding initially allocated in the 2004 Budget.

12.12 Officials at the Treasury Board Secretariat informed us that the government included the new clause to eliminate the existence or appearance of government control of the Foundation. The issue of control is the basis for determining whether a foundation is part of the government’s accounting entity. However, we noted the government’s decision, announced in the 2006 Budget, to include Sustainable Development Technology Canada’s revenues and expenses in its financial statements. This decision effectively places the Foundation

within the federal government's reporting entity. Therefore, the government's reason for having the clause no longer exists.

12.13 In our interviews with the Foundation's senior managers and several directors, we were told that the new clause is considered unduly restrictive. Often, it is difficult to ensure that the majority of directors at Board meetings are not government appointees. Under this clause, the Board cannot make any decisions during a meeting if government appointees are in the majority. As the Board generally meets only four times a year, this could seriously affect its operations.

12.14 In the spring of 2005, the Foundation introduced a new by-law to address the difficulties arising from the clause. If a decision is made and the federal government appointees are in the majority, the by-law requires a second vote by the non-government appointees. When we interviewed the directors, they told us that this two-step process was inefficient, and that it impeded the Board's operations.

12.15 We noted that some other organizations with federal funding have similar clauses in their funding agreements or in their legislation. In our view, the governance structure of these organizations is different from that of Sustainable Development Technology Canada.

12.16 We found that the clause is unduly restrictive and that it is no longer relevant given the decision announced in the 2006 Budget to include the Foundation's revenues and expenses in the government's financial statements.

New clause interferes with the role of federally appointed directors

12.17 In our April 2002 Report, Chapter 1, *Placing the Public's Money Beyond Parliament's Reach*, we recommended that the Privy Council Office ensure that sponsoring departments fully define the roles and responsibilities of federal appointees to boards. In its response to this recommendation, the Privy Council Office focused on the guidance it provides to newly appointed chairs of Crown corporations and heads of agencies. However, it also referred to the requirement of the *Canada Business Corporations Act* that directors act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. The directors of the Foundation are subject to this requirement.

12.18 The 14th Report of the House of Commons Standing Committee on Public Accounts considered Chapter 1 of our

2002 April Report. In October 2003, the government responded to the Committee's 14th Report and stated that

On the matter of [the] roles and responsibilities of federal appointees to boards of directors, such appointees do not represent the Department or the government. Instead, they have a responsibility to their boards and therefore their actions would be governed by the Foundation's by-laws, the Acts they are established under, as well as the policies and guidelines issued by the boards. Board directors also have a fiduciary responsibility to act in the best interest of the foundations. Guidance to federal appointees regarding their responsibilities as board directors should therefore come from the foundations themselves.

12.19 These responses speak to the roles and responsibilities of federally appointed board members. In our view, every director has a fiduciary duty to actively participate in the function of the Board, that is, in supervising the management of the business and affairs of the Foundation. The new clause prevents federal government appointees from forming a majority of the persons required to form a quorum or to make any decision of the Foundation. It interferes with their ability to carry out their duties and influence matters relating to the supervision of the Foundation's business, since their views and votes will only be counted in situations where government appointees are in a minority.

12.20 Treasury Board Secretariat officials informed us that the new clause (see paragraph 12.10) deals with quorum, not the role of board members. However, we do not agree. In our view, the new clause has a direct impact on how federal government appointees participate in board meetings.

12.21 Recommendation. Natural Resources Canada and Environment Canada should consult the Treasury Board Secretariat and the Privy Council Office to clarify the necessity of restricting the participation of federal government appointees to the Board of Directors of Sustainable Development Technology Canada in the decision-making process.

The government's response. The government agrees. Natural Resources Canada and Environment Canada have initiated discussions with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the Board of Directors of Sustainable Development Technology Canada. Consultations are scheduled to be completed in November 2006.

Conclusion

12.22 The government's decision to restrict the role of federally appointed directors

- affected the Board's governance, and
- interfered with the ability of federally appointed directors to carry out their duties.

About the Audit

Objective

Our objective was to determine whether the government's position on the role of federal appointees to the Board of Directors supported effective board governance for Sustainable Development Technology Canada.

Scope and approach

We reviewed documents and interviewed senior officials from the following five entities:

- Sustainable Development Technology Canada,
- Natural Resources Canada,
- Environment Canada,
- Treasury Board Secretariat, and
- Privy Council Office.

Criteria

We expected that

- the Treasury Board Secretariat, on behalf of the government, would provide guidance to the sponsoring departments that supports good governance;
- the sponsoring departments would follow the Secretariat's guidance and make provisions for good governance arrangements through the funding agreement; and
- the Foundation would promote good governance arrangements.

Audit work completed

Audit work for this chapter was substantially completed in May 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 12. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraph where the topic is discussed.

Recommendation	Government's response
Governance of the Foundation's affairs	
<p>12.21 Natural Resources Canada and Environment Canada should consult the Treasury Board Secretariat and the Privy Council Office to clarify the necessity of restricting the participation of federal government appointees to the Board of Directors of Sustainable Development Technology Canada in the decision-making process. (12.9–12.20)</p>	<p>The government agrees. Natural Resources Canada and Environment Canada have initiated discussions with the Treasury Board Secretariat and the Privy Council Office regarding restrictions on the participation of federal appointees on the Board of Directors of Sustainable Development Technology Canada. Consultations are scheduled to be completed in November 2006.</p>

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