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## Chapter 3: Non-Governance

### Why we did this audit:

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

### Overall conclusions:

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

### What we found in our audit:

#### What worked well

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

#### Weaknesses we noted

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

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

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

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

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

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

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# 3 Non-Governance

## Audit Objectives and Scope

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

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

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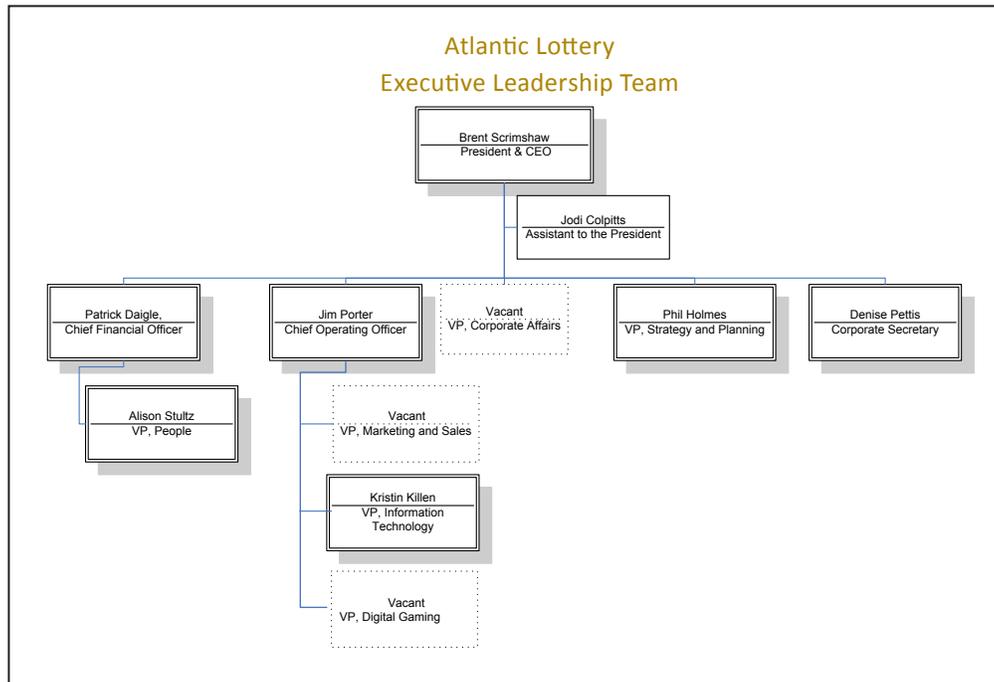
## Conclusion and summary of observations

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

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

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

Exhibit 3.1



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

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

**Exhibit 3.2**

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

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

**Exhibit 3.3**

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

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

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

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

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

**Exhibit 3.4**

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

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

**Exhibit 3.5**

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

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

**Recommendation 3.1**

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

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

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

**Exhibit 3.6**

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

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

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

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

**Exhibit 3.7**

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

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

**Recommendation 3.2**

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

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

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

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

### Exhibit 3.8

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

- 3.23 In addition to not updating the payroll system to reflect contribution rate changes, we also identified instances in which individual employees' contributions to their pension plan exceeded the maximum allowable amount under the Income Tax Act. Since 2011, employee overcontributions totaled approximately \$24,000 and impacted four employees. Management told us this happened because the contribution limit was not properly set in the payroll system. Atlantic Lottery identified the issue in December 2015 and has addressed the overcontributions with the Canada Revenue Agency.
- 3.24 While the dollar impact of these errors was relatively small, these types of issues have the potential to be costly for both the Corporation and its employees. These errors went undetected for two to four years before Corporation staff identified the issues. This suggests additional controls are needed to prevent errors in the future.

### Recommendation 3.3

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

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

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

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

**Recommendation 3.4**

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

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

**Travel, Hospitality, and Board Expenses**

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## Conclusion and summary of observations

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

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

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

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

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

### **Recommendation 3.5**

Atlantic Lottery should revise its travel and expense policy to:

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

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

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

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

**Recommendation 3.6**

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

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

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

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

**Recommendation 3.7**

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

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

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

**Contract Management**

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Conclusion and summary of observations

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

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

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

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

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

**Recommendation 3.8**

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

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

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

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

**Recommendation 3.9**

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

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

**Recommendation 3.10**

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

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

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

### **Recommendation 3.11**

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

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

## **Procurement of Services**

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### Conclusion and summary of observations

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

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

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

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

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

**Exhibit 3.9**

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

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

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

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

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

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

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

**Recommendation 3.12**

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

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

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

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

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

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

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

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