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Governance Audit of  
Greater Sudbury Utilities Inc. &  
Greater Sudbury Hydro Inc.

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August 31, 2018  
FINAL REPORT

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## **1. ORGANIZATIONAL BACKGROUND**

Greater Sudbury Utilities Inc. (GSUI) is a company, which through its subsidiaries, delivers utilities and telecommunications goods and services across the Greater Sudbury area. The GSUI group of companies includes one regulated affiliate – the Greater Sudbury Hydro Inc. (GSH) – and three non-regulated affiliates: @Home Energy; Agilis Networks; and ConverGen.

GSUI is a corporation incorporated under the Ontario Business Corporations Act (*OBCA*) with the City of Greater Sudbury as the sole shareholder. GSUI is governed by a five-person Board of Directors – 3 Members of Council and two community representatives – appointed by the Shareholder.

In fiscal year 2017, GSUI generated \$154.2 million in revenue and \$144.1 million in expenses resulting in an operating surplus of \$10.1 million.

### **Greater Sudbury Hydro**

GSH is a local distribution company, incorporated as an Ontario Business Corporation with the GSUI as the sole shareholder. GSH is regulated by the Ontario Energy Board (OEB), which approves rates and establishes and monitors performance standards. GSH distributes electricity to approximately 47,362 customers within parts of Greater Sudbury and parts of the Municipality of West Nipissing.

GSH operates at arm's-length from the City and is governed by its five-member Board of Directors, which consists of three Members of Council and two community representatives. GSH operations must comply with all relevant OEB regulation, in particular the Affiliates Relationship Code that establishes the rules governing the relationship between GSUI and its regulated and non-regulated affiliates.

The mission of GSH is to provide safe, reliable electricity with good value for its customers, while helping them take advantage of emerging energy generation and conservation technologies.

As a regulated entity, GSH does not make a profit from selling energy to its customers.

### **Ontario Energy Board Corporate Governance Guidance**

GSUI – in particular GSH – operates in a highly regulated environment with the OEB acting as its chief regulator. The OEB is introducing new mandatory governance reporting requirements and has published draft guidance on best practices in corporate governance for regulated utilities, including GSH. GSH has engaged an outside consultant (Elenchus) to assist it in planning with respect to responding to these new requirements and guidance.

## **2. GOVERNANCE AUDIT: APPROACH & EXECUTION**

The governance audit was completed based on the assessment framework detailed in the *Practice Guide to Auditing Oversight* (“*Practice Guide*”) published by the Canadian Audit & Accountability Foundation. Based on the *Guide*, the following Approach, Objectives and Assessment Criteria were used.

## 2.1 Approach

The audit focused on the oversight structures and systems in place within the GSUI and GSH, including

- Structure and mandate of each organization
- Definition of roles and responsibilities of each organization and its senior leadership team
- Oversight exercised by each organization over its respective areas of responsibility, and
- Oversight exercised by the City or other relevant government bodies over each organization.

## 2.2 Scope

The scope of the audit included activities from January 1, 2015 to April 30, 2018.

## 2.3 Objectives & Assessment Criteria

The key objective of the audit was to assess the effectiveness of the design of oversight structures and processes. As such, the audit was not specifically designed to assess whether the oversight processes are operating as designed and/or the outcomes generated by these oversight processes. The table below sets out the audit objectives and related assessment criteria. More detailed criteria were developed and used to conduct the audit.

<b>Audit Area</b>	<b>Audit Area Objectives</b>	<b>Audit Area Assessment Criteria</b>
<b>Overall Oversight Framework</b>	To determine whether the structures and processes established for the organization set the framework for effective oversight	The governance structure and mandate of the organization are sufficient and appropriate to provide a framework for effective oversight
<b>Oversight Roles &amp; Responsibilities</b>	To determine whether the board (or governing body) has clear oversight roles and responsibilities and a clear mandate to carry out specific oversight functions	The oversight body and its committees and members have clearly defined oversight roles and responsibilities
<b>Performance Monitoring</b>	To determine whether the board (or governing body) has put in place adequate systems and practices to monitor the organization's performance in meeting its established objectives	The oversight body has established a performance management framework for the organization  Performance targets and pertinent indicators are in place to enable the oversight body to monitor properly organizational performance
<b>City Oversight</b>	To determine whether the city/other oversight bodies has established a clear framework for the oversight of the organization	The city (or other oversight body) has defined and communicated its expectations with regard to organizational performance and the reporting thereof

## 2.4 Execution

The audit was completed based on a number of key activities:

- **Documentary Review:** Relevant documentation was collected and reviewed in relation to objectives and assessment criteria;
- **Interviews:** Interviews were conducted with selected members of the GSUI and GSH Board of Directors, management and City staff; and,
- **Informal Benchmarking:** Limited, informal benchmarking analysis was completed based on available documentation and stakeholder input.

## 2.5 Audit Standards

We conducted the audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we adequately plan for the audit; properly supervise audit staff; obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions; and prepare audit documentation related to the planning, conducting, and reporting for each audit. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit.

For further information regarding this report, please contact Ron Foster at extension 4402 or via email at [ron.foster@greatersudbury.ca](mailto:ron.foster@greatersudbury.ca)

## 3. SUMMARY

GSUI/GSH governance and oversight structures and processes are well designed and are complemented by a strong management team and strong Boards. However, corporate governance standards and expectations are rising within the regulated utilities sector as evidenced by the OEB's enhanced attention to and emphasis on good corporate governance at rate-regulated utilities.

GSUI/GSH has responded effectively to these evolving OEB expectations through its work with Elenchus and should continue with this work. In particular, GSUI/GSH should focus on enhancing the documentation of its governance structures and process and continue to assess opportunities to enhance its corporate governance in areas such as Board size and composition and the recruitment process and competencies for Directors.

In accordance with the Shareholder Declaration, a Dividend Policy should be formalized for the review and approval of the Shareholder.

Finally, the City should consider opportunities to improve its Member orientation programs in order to provide enhanced information to Members considering opportunities on the Boards of various agencies, boards and controlled corporations (ABCs), in particular, with respect to the role of Members of Council as Directors at ABCs and the duties owed by Members to the ABC in their role as Director.

Specific observations, findings and recommendations are detailed in the sections that follow.

#### 4. OBSERVATIONS

The following section sets out the key observations which relate to the design of the oversight structures and processes in place with respect to GSUI and GSH. Observations related to the operation of these structures and processes are also noted where relevant.

##### 4.1 Overall Oversight Framework

The oversight framework is generally effectively designed and the governance structure and mandate of the organizations are sufficient and appropriate to provide a framework for effective oversight. For example:

- a) The mandate and roles and responsibilities of the Shareholder and the Boards are documented in a variety of sources, including GSUI By-Law No.1 and the Shareholder Declaration which is Schedule A to By-Law 2008-137.
- b) A draft Board Mandate is in place. The Board currently follows this Mandate. The Mandate is considered to be draft as certain provisions are not in force pending proposed changes to the Shareholder's Agreement.
- c) The Shareholder Declaration indicates that the Shareholder anticipates that the Board may establish Audit & Finance, Governance and Co-ordination Committees and must establish a Nominating Committee. The Board has established the following Committees: Audit & Finance Committee, New Business Development Committee and Human Resources & Governance Committee and Nominating Committee. Formal Terms of Reference have been established for each of these Committees which document their roles and responsibilities.
- d) There is currently no formal mandate in place for the Board Chair.
- e) The Shareholder Declaration – based on the *Ontario Business Corporations Act* – requires the respective Boards and Board Directors to act honestly and in good faith with a view to the best interests of the GSUI or its Subsidiaries (including GSH) and to exercise a reasonably prudent standard of care, diligence and skill. In addition, the GSUI has established a Code of Conduct that applies to all Directors, Officers and Employees and that includes provisions related to conflicts of interest and undue influence.
- f) New Directors are provided with orientation sessions to acquaint them with the strategy and operations of the GSUI and GSH and key organizational risks and initiatives. The 2015 Orientation Package included presentations covering the GSUI Corporations, the regulatory environment, GSUI operations, industry trends and issues and current organizational development initiatives. It also included a specific session/presentation on the legal duties and obligations of Directors.
- g) While there is no formal Director Continuing Education Policy, Directors are provided with the opportunity to participate in a variety of continuous learning activities such as conference participation and formal training sessions. In addition, Directors also participate in training provided by Governance Solutions, Inc.
- h) A third party assessment of Board effectiveness is scheduled to be completed by October 31, 2018.

- i) The Shareholder is responsible for appointing Directors to the Board. Three Directors from each Board are required to be Members of Council, including the Mayor or his or her delegate. The additional two Directors for each Board are required to be “Private Directors” – neither Members of Council nor City employees – and are appointed by Council. No Private Director may sit on both Boards simultaneously.
- j) The Nominating Committee of the Board is responsible for recommending Private Director Board appointments to the Shareholder. When doing so, it is expected to consider the Director Qualifications noted in Section 4.2 of the Shareholder Declaration. In addition, the Committee utilizes a Skills Matrix that maps current Director’ competencies and identifies current strategic opportunity areas – i.e., areas of competency that could be improved and, if possible, should be targeted as part of recruitment process.
- k) Section 2 of the Shareholder Declaration establishes the permitted business activities of the GSUI and its Subsidiaries, which include the activities – e.g., transmitting or distributing electricity – that are conducted by the GSH.
- l) Affiliates Relationship Code established by the OEB sets out rules that govern the conduct of utilities as that conduct relates to their respective affiliates in various matters such as: cross-subsidization, preferential access and unfair advantage. Code requires GSUI to monitor compliance with the Code. CEO is required to provide formal certification of compliance with the Affiliates Relationship Code as part of annual submission to the OEB.

#### **4.2 Board Oversight Roles & Responsibilities**

The oversight roles and responsibilities of the GSUI and GSH Boards of Directors are defined and documented and the Boards have documented mandates to execute specific oversight responsibilities. For example:

- a) Shareholder Declaration requires the Board to establish various Policies that are subject to Shareholder approval (see section 4.4 below). In addition, the Board is required to implement a number of other Policies not subject to Shareholder approval – including: Distribution Rate, Risk Management, Environmental and Employment Policies – and to develop a long-term Strategic Plan.
- b) GSUI management provides the Board with a detailed strategic plan. The strategic plan consists of two components: i) Distribution System Plan (DSP) which is a detailed five-year rolling plan setting out the medium term approach to maintaining and renewing distribution assets; and, ii) the Smart Grid Compass Report that sets out strategic plans across all GSUI business lines. The strategic plan is reviewed and recommended for Board approval by the New Business Development Committee.
- c) GSUI is required to complete an enterprise risk assessment annually and present the resulting Corporate Risk Matrix to the Audit & Risk Management Committee of the Board. Board is ultimately responsible for approving the Risk Matrix. The Risk Matrix is updated as required and a root cause analysis is completed on an area of Non-Conformance or Corrective Action.
- d) By-Law #1 provides the Board with the authority to appoint a President (CEO) and other members of the senior executive team including Vice-Presidents, Secretary and Treasurer. The Board reviews CEO remuneration but does not complete an annual performance review of the CEO.

- e) Board Committees have specific areas of oversight responsibility. For example, the New Business Development Committee is responsible for understanding and managing forward-looking strategies and risks, the HR & Governance Committee is responsible for overseeing human resources planning and corporate governance, and the Audit & Risk Committee is responsible for overseeing financing and financial reporting and controls, risk and external audit.
- f) Board receives regular reporting from management on operational performance, including areas such as asset management. For example, Board recently received and reviewed detailed operational review completed by external consultant (Siemens).
- g) Boards of both GSUI and GSH meet together in order to provide visibility for all Directors into the strategy and operations of both entities.

### **4.3 Performance Monitoring & Reporting**

The Board has established systems and practices to monitor the performance of the organization and to assess the extent to which the organization has achieved its established objectives. For example:

- a) Directors indicated that Board reporting packages were thorough, providing detailed financial and operational information and that management was very responsive to any questions from the Board.
- b) DSP includes annual goals that are established in each year's capital budget. Progress is reported against these goals at each Board meeting in the form of a Capital Expenditure Report.
- c) Action Items from Board meetings are captured in Board meeting Minutes and tracked to resolution.
- d) The Board receives detailed OEB Scorecard that includes performance measures and Key Performance Indicators (KPI) for GSH related to: Customer Focus, Operational Effectiveness, Public Policy Responsiveness and Financial Performance.
- e) The Board receives and reviews Annual Report that is presented to the Shareholder and includes variety of operational performance measures.
- f) Management is currently developing KPI to monitor performance with respect to asset management.
- g) While internal audits are conducted quarterly to assess compliance with internal policies, the related audit reports and identified issues are not formally reported to the Board.

### **4.4 City (Shareholder) Oversight**

The City has established a generally effective framework for the oversight of the GSUI and GSH. For example:

- a) Roles of the Shareholder and the Board are detailed in By-Law #1 and the Shareholder Declaration as noted in Section 4.1 above.

- b) The Board is required to present a detailed Annual Report to a meeting of Council. The Annual Report consists of three parts: the Annual Report, the Consolidated Financial Statements and a formal presentation delivered by the CEO, Vice-President – Corporate Services and the Chief Financial Officer, who are all available to provide whatever additional information may be required by the Board Members.
- c) The Shareholder Declaration requires the Board to establish Capital Structure, Returns, Dividends and Coordination Policies that are subject to the review and approval of the Shareholder:
- Capital Structure Policy - determined to be unnecessary by the Board as OEB has established a deemed capitalization policy for the GSUI.
  - Returns Policy - also deemed unnecessary as returns on regulated assets are established by the OEB. The Board has established a target internal return rate of 15% for non-regulated activities though this may be modified by the Board as appropriate.
  - Dividends Policy has not been established but the Board has adopted the position that in lieu of payment of dividends any service provided to the City will be provided at cost or at a significant discount from market rates.
  - Coordination Policy was determined to be unnecessary given decision to expand the number of Members of Council on the Board (see point f below).

As noted above, the Declaration also requires the Board to establish several other Policies that are approved by the Board only but communicated to the Shareholder.

- d) The Shareholder Declaration also requires the Board to report to Council on major business developments or materially significant or adverse results at the discretion of the Board. The GSUI regularly reports to individual Members of Council in the event of issues (significant customer issues or power outages) localized within their area of representation or to the full Council for more widespread issues and/or for any issues that – in the judgement of the Board and Management – could be of interest to Council or are likely to come to the attention of Council.
- e) Senior City staff – e.g., City Manager – are invited to attend Board meetings. In addition, the CEO meets regularly with the City Manager to discuss strategy, operations and issues related to GSUI, including GSH, and to discuss potential areas of mutual cooperation.
- f) The Coordinating Committee mentioned in the Shareholder Declaration was not created as the decision was made instead to increase the number of Members of Council on the Board from one to three. In addition, there are regular coordinating meetings of staff who are directly involved in provision of the water/wastewater billing system and in other areas such as telecommunications services, landfill gas generation and street light maintenance and capital.

## 5. FINDINGS

The audit assessed the effectiveness of the design of oversight structures and processes. As noted above, the audit was not specifically designed to assess whether the oversight processes are operating as designed



and/or the effectiveness of the outcomes generated by these oversight processes. However, where operational observations were noted they have been identified above.

Based on the results of the audit, the oversight structures and processes in place with respect to the GSUI and GSH generally appear to be effectively designed but the following Findings are noted:

- 1) GSUI/GSH have been reviewing and assessing corporate governance structures and policies in response to enhanced OEB focus on corporate governance practices and reporting. Current GSUI/GSH corporate governance structures and policies may require enhancement and/or further formal documentation to meet OEB expectations in a number of areas (see Recommendations Section below for details).
- 2) The current Shareholder Declaration is dated and includes references to required Policies and Committees (e.g., Coordinating Committee and Coordinating Policy) that have never been established for a variety of reasons.
- 3) A formal Dividends Policy has not been established or reviewed with the Shareholder.
- 4) Roles and responsibilities of the Board Chair and the CEO are not documented in formal Mandates.
- 5) Management reporting to the Board – while comprehensive – could be enhanced by developing a more formal Performance Management Framework that reports actual performance against Key Performance Indicators explicitly linked to objectives detailed in the Strategic Plan.
- 6) City orientation programs for new and returning Members of Council provide only limited context and information/guidance to Members with respect to the strategy and operations of Agencies, Boards and Corporations (“ABC”) managed by the City – such as GSUI/GSH – and the roles and responsibilities of Members when acting as Director for an ABC.

## 6. RECOMMENDATIONS

The following Recommendations are provided based on the Findings noted above:

- 1) The Boards and management should continue to work with Elenchus to assess options to enhance GSUI/GSH corporate governance. In particular, the assessment should include:
  - a) Review and update of formal, written mandates for the Boards and all Board Committees

Management Response:

The HR/Governance/Nominating Committee completed work with Elenchus and recommended adoption of Terms of Reference for the following Board Committees: Audit, Finance and Risk Committee; HR, Governance and Nominating Committee; and New Business Development Committee. Those Terms of Reference are attached as Attachment 1. The Board approved the recommended Terms of Reference.

The Board is awaiting the approval of modifications to the Shareholder’s Declaration prior to adopting the new Board Mandate.

- b) Review and update of Shareholder Declaration to ensure that Declaration is consistent with current practice and current circumstances.

Management Response:

The HR, Governance, Nominating Committee has completed work with Elenchus on a draft revision to the Shareholder's Declaration. The revisions to the Shareholder's Declaration will be included on the agenda of the next Annual General Meeting.

- c) Formal documentation of Board Chair and CEO roles and responsibilities in the form of written mandates.

Management Response:

The HR, Governance and Nominating Committee has developed a draft written mandate for the Board Chair, appended as Attachment 2, and CEO, appended as Attachment 3. The drafts will be reviewed, amended if required and adopted by the Board at the next regular Board Meeting.

- d) Changing composition of Boards – in particular the GSH Board – to include additional Independent Directors and increase the percentage of Independent Directors on the Board.

Management Response:

See the response in part b above. The revised Shareholder's Declaration takes into consideration a majority of the Independent Directors on the GSHI Board.

- e) Investigating options to enhance the use of the Skills Matrix to assess Board needs and the suitability of Directors and investigating ways in which the matrix could be applied to the appointment process for Directors who are Members of Council.

Management Response:

The GSUI Board of Directors and Management will support this initiative as required once Council has reviewed and made a determination.

- f) Reviewing current orientation program for new Independent Directors to ensure it remains consistent with industry practice, organizational needs and OEB expectations. When completing this assessment, the Board and management should consider the guidance provided in National Policy 58-201 Corporate Governance Guidelines and in OEB-2014-0255 Draft Report of the Board on Corporate Governance Guidance for OEB Rate-Regulated Utilities.

Management Response:

Orientation for new directors will involve both Corporate and Regulatory Counsel to ensure that current best practices and regulatory guidance are included in the information given to new Directors. This work will commence shortly in anticipation of a February start date.

- 2) In accordance with the Shareholder Declaration, a Dividend Policy should be formalized for the review and approval of the Shareholder.

Management Response:

At our last Shareholder's meeting, Council asked that we provide some analysis of the value that GSU provided the Shareholder as well as discuss a potential dividend framework. The Board will continue this work and report back to the Shareholder as soon as practicable.

- 3) Management should work with the Board to review options to continue to enhance Board reporting materials in particular to ensure that management reporting includes reporting on performance against Key Performance Indicators (KPIs) that are linked directly to a wider range of objectives included in the Strategic Plan and any other relevant strategy or planning documents that support the Strategic Plan (e.g., Asset Management Plan).

Management Response:

The Board and Management will meet the second week of November to refine the current term goals for 2019. Select KPIs for each goal will be determined and documented in the 2019 work plan. The KPI results will be reported regularly to the Board throughout 2019 to monitor progress and make any adjustments necessary. Additionally, the current term goals, KPIs and their targets will be considered in assessing CEO performance for 2019.

- 4) The orientation program for new and returning Members of Council managed by the City should include an enhanced focus on the opportunities available to Members to act as Directors for agencies, boards and controlled corporations (ABCs), the responsibilities associated with this role – including the duties owed to the ABC in capacity of Director – and more in-depth background on ABC structures, strategies and operations.

Response from City Manager:

The City of Greater Sudbury is updating its Council Orientation Process and associated materials in preparation for the new council term which begins on December 1, 2018. Additional information will be provided in order to better orient councillors to the role of the Board