Saskatchewan Telecommunications Holding Corporation

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Main points

Saskatchewan Telecommunications Holding Corporation (SaskTel) is a large and complex company. It has diversified the services it provides because of changes in the telecommunications industry.

SaskTel operates its business through separate companies, as opposed to as divisions within SaskTel itself. Using separate companies poses risks to transparency and good governance. It is important that SaskTel take appropriate steps to manage those risks.

We assessed whether SaskTel has adequate processes to govern companies that it owns and controls. Although SaskTel's processes are comprehensive and sophisticated, two areas require improvement. We recommend that SaskTel improve how it communicates its governance expectations to the companies. We also recommend that SaskTel improve how it assesses the effectiveness of the boards of the companies.

In addition, where we completed our work, we found the 2003 financial statements of SaskTel and its companies are reliable. They had adequate rules and procedures to safeguard public resources and they complied with authorities governing their activities. At the date of this report, the audits of two companies - Navigata Communications Inc. Pension Plan and Retx, Inc. are not done. We will report those results in a future report.

Introduction

Saskatchewan Telecommunications Holding Corporation (SaskTel) provides telephone, cell phone, internet, and e-business services.[1] It maintains investments in companies that provide a variety of products and services around the world. For information on SaskTel's investments in companies, see SaskTel's web site at http://www.sasktel.com/.

In recent years, SaskTel has diversified the services that it provides. It has expanded into new lines of business because it expects its local telephone and long distance services will continue to become smaller.

Audit conclusions and findings

Our Office worked with KPMG LLP, the appointed auditor, to carry out the audits of SaskTel and its following agencies:

- Saskatchewan Telecommunications and its related pension plan, Saskatchewan Telecommunications Pension Plan
- DirectWest Publishing Partnership
- SecurTek Monitoring Solutions Inc.
- Navigata Holdings Inc. and its related pension plan, Navigata Communications Inc. Pension Plan.
- Hospitality Network Canada Inc.
- Business Watch International Inc.
- Retx, Inc.
- Saskatchewan Telecommunications International Inc.

We followed the framework in the *Report of the Task Force on Roles, Responsibilities and Duties of Auditors.* (To view a copy of this report, see our web site at http://www.auditor.sk.ca/.)

As described below, at the date of this report, the audits of Navigata Communications Inc. Pension Plan and Retx, Inc. are not fully done. We will report the results of these audits in a future report.

In our opinion for the completed audits, for the year ended December 31, 2003:

- **The financial statements of SaskTel and each of the above listed agencies are reliable.**

[1] We refer to Saskatchewan Telecommunications Holding Corporation as SaskTel for ease of reference.

- **SaskTel and each of the above listed agencies had adequate rules and procedures to safeguard public resources.**
- **SaskTel and each of the above listed agencies complied with authorities governing their activities relating to financial reporting, safeguarding public resources, revenue raising, spending, borrowing, and investing.**

For Navigata Communications Inc. Pension Plan, the audit of the financial statements is done. However, the audit of the adequacy of the Plan's rules and procedures to safeguard public resources and its compliance with authorities governing its activities is not yet complete.

For Retx, Inc., we work with Grant Thornton LLP, the appointed auditor, to carry out the audit of Retx, Inc. The audit of Retx, Inc. is not done.

In the next section, we describe matters related to improving governance at SaskTel. In Chapter 18 - Pensions, we discuss our planned work on the SaskTel Pension Plan's annual report.

Assessing governance

The objective of our audit was to assess whether SaskTel has adequate processes to govern companies it owns and controls.[2] We focused on SaskTel's processes at November 30, 2003 to govern the companies listed in Exhibit 1.

Exhibit 1—Operating companies controlled by SaskTel and percentage ownership

Saskatchewan Telecommunications	100.0%
Saskatchewan Telecommunications International, Inc.	100.0%
DirectWest Publishing Partnership	100.0%
Hospitality Network Canada Inc.	94.1%
SecurTek Monitoring Solutions, Inc.	100.0%
Navigata Communications Inc.	100.0%
Business Watch International Inc.	94.3%
Retx, Inc.	91.7%

(Source: Saskatchewan Telecommunications Holding Corporation Financial Statements, December 31, 2003)

[2] We use the word company to include incorporated businesses and partnerships.

In our audit, we used the following definition of governance from The Canadian Institute of Chartered Accountants.

> Governance means the process and structure used to direct and manage an organization so that it fulfills its mandate.
> Governance responsibilities include:
> - monitoring the organization's mission, vision and strategy;
> - approving and monitoring the organization's ethical values;
> - monitoring management control;
> - evaluating senior management;
> - overseeing external communications; and
> - assessing the board's effectiveness.[3]

Audit criteria and approach

We followed *The Standards for Assurance Engagements* established by The Canadian Institute of Chartered Accountants.

To assess the adequacy of SaskTel's processes to govern its companies, we used the criteria set out in Exhibit 2. We developed the criteria from our review of international literature and the work of other legislative audit offices. SaskTel agreed with the criteria.

Exhibit 2—Audit Criteria

To adequately govern its companies, SaskTel must have processes to:

1. communicate governance expectations to company boards

   Consider
   - 1.1 provide guidance to companies
   - 1.2 communicate company obligations clearly
   - 1.3 require companies to document key governance practices

2. assess company board effectiveness

   Consider
   - 2.1 identify governance-related risks
   - 2.2 review governance activities based on risk assessment

3. monitor performance of companies

   Consider
   - 3.1 require regular performance reports (e.g., activities, risks, financial and non-financial information)
   - 3.2 review performance information regularly

[3] Canadian Institute of Chartered Accountants (1995), pp.2-3.

4. take follow-up action to promote consistent governance

   Consider
   - 4.1 provide feedback to company boards
   - 4.2 verify company boards take necessary action
   - 4.3 make necessary changes to improve governance

Complex corporate structure

SaskTel operates many of its businesses through separate companies. It has a complex structure.

At December 31, 2003, SaskTel owned all or part of 17 companies (i.e., 14 corporations and three partnerships) that had active operations in the year. It had a controlling interest in 11 of these companies in that it was the sole shareholder of five and owned more than 50 per cent of six. In addition, SaskTel owned 34 other companies that had no active operations in 2003. (For additional detail on these companies, refer to the Notes to the December 31, 2003 Financial Statements contained in *SaskTel 2003 Annual Report*.)

SaskTel does not operate all of its businesses as separate companies. It operates some businesses within its own corporate structure, as operating divisions (for example, SaskTel Mobility).

Choosing to operate through separate companies

Choosing to operate a business as a separate company as opposed to as an operating division is a management decision. There can be many reasons to use a separate company to operate a business. These include the fit of the business with existing business lines, the method or timing of the acquisition, the ease of carrying on business in certain jurisdictions, the need to manage risks such as exposure to legal liability, and for acquired entities, the tax status of the entity.

The decision to use a separate company carries with it certain responsibilities and duties. There are legal responsibilities and duties for those who manage, those who own (the shareholders), and those who govern on behalf of the shareholders (the board).

In addition to additional responsibilities, the use of a separate company also involves additional risks. These risks can vary depending on the level of ownership. Having controlling interest in another company can provide a company with greater opportunity to manage associated risks.

A risk that often accompanies complex organizational structures is the loss of transparency. A complex structure can make it hard to figure out who owns what and who is responsible for what.

There are additional considerations for Crown corporations that use separate companies to carry out business. Special laws govern Crown corporations. These laws can restrict the nature or extent of business of the Crown corporation. For example, SaskTel is limited to the business of telecommunications under *The Saskatchewan Telecommunications Ac*t.

These laws typically require the Crown corporation to seek specific approval for certain transactions within specific timeframes. For example, SaskTel must obtain the prior approval of Cabinet when it plans to buy land worth more than $100,000.[4] Unlike the private sector, the Crown corporations can only do what their governing laws permit.

In addition to laws, Crown corporations are also subject to government policies. For example, Crown Investments Corporation of Saskatchewan (CIC) sets policies to which SaskTel is subject.

When a Crown corporation creates or buys another company to carry out its business, it must take steps to ensure that company's activities do not exceed its own authority. This is a more difficult task where the Crown corporation does not own all of the shares of that company. In these cases, the wishes and interests of the other owners may not be the same as those of the Crown corporation.

The separate companies used to carry on business are one step removed from the direct control of the parent company. They have the legal ability to enter into contracts independent of their parent. They may make decisions that are not consistent with the direction, the values, or authority of the parent company. These decisions can be difficult to reverse and can be costly.

[4] *The Saskatchewan Telecommunications Act*, subsection 11(3).

The Government has encountered challenges in this area. For example, in 1998, we reported that Channel Lake undertook activities that exceeded the limits placed on it by its parent company, SaskPower.[5]

CIC subsequently set policies for governance of companies that are wholly owned by Crown corporations. These policies are in part a response to limit how Crown corporations use these companies. CIC has stated that wholly owned companies are subject to "…the same level of authorization and governance standards…as are applied to the parent Crown in accordance with the approved CIC Crown Governance model."[6]

Conclusion and recommendations

During the last several years, SaskTel has responded to the increased focus on governance in the private and public sectors. SaskTel has made, and continues to make, significant improvements in its processes to govern companies it owns and controls. SaskTel's processes to govern these companies are comprehensive and sophisticated.

We conclude that at November 30, 2003, SaskTel had adequate processes to govern companies it owns and controls except for the matters reflected in the following recommendations.

1. **To improve its processes to communicate governance expectations to companies it owns and controls, we recommend that Saskatchewan Telecommunications Holding Corporation:**

   - **ensure that the board of each company has current written terms of reference;**

   - **highlight, for example in corporate policy, that the SaskTel Board has delegated to the President of SaskTel its authority to name the board members of SaskTel's companies; and**

[5] 1998 Fall Report – Volume 2, Chapter 21. Also, the final report of the Standing Committee on Crown Corporations into the Channel Lake Inquiry was tabled October 15, 1998.
[6] CIC Governance Policy for Crown Held Subsidiaries, May 2002, p.1.

- **ensure that companies it controls, or plans to control, are subject to shareholder agreements and articles of incorporation that reflect the governance expectations placed on SaskTel.**

2. To improve how it assesses the effectiveness of the boards of companies it owns and controls, we recommend that Saskatchewan Telecommunications Holding Corporation:

- **document the governance risks and identify levels of governance risk that are acceptable for each company;**

- **require each company board to evaluate its senior management at least annually; and**

- **require each company to provide the SaskTel Board with its evaluation of its board.**

Key findings (by criteria)

In this section, we set out our expectations (in italics) for each of the criteria, together with our key findings. We describe the processes SaskTel used to govern companies it owns and controls (companies).

Communicate governance expectations to company boards

To share its governance expectations with the boards of companies it owns and controls, we expected SaskTel would:

- *provide guidance to companies regarding the expected governance structure and the authority of key parties;*
- *clearly communicate company obligations that would be aligned with SaskTel's own responsibilities; and*
- *require companies to document their key governance practices.*

SaskTel manages its governance risks by placing its own senior management on the boards of its companies. By using this approach, SaskTel has chosen, for the most part, to treat the companies in a similar manner to how it treats an internal division.

The President and CEO (President) of SaskTel names members to the boards of the companies. The Board of SaskTel delegated this authority to the President. In some cases, shareholder agreements also provide for the appointment of outside Board members (e.g., to represent minority shareholders).

The use of SaskTel senior management to serve as company board members accomplishes a number of important purposes. It provides a communication mechanism that helps ensure that companies receive and clearly understand SaskTel's expectations (including corporate values, direction, and performance expectations). This communication mechanism also helps inform SaskTel of company performance. Further, it provides SaskTel with ready means of making changes at companies.

SaskTel should take steps to better document its governance practices and those of its companies. As noted, the Board of SaskTel has delegated to SaskTel's President its authority to name the board members of companies. The Board noted this delegation in its minutes. Unlike other key board direction, it is not otherwise documented.

This delegation is a central feature of how SaskTel governs its companies. The delegation should be clearly and prominently set out with the other high-level board policies that impact governance. It is important that agencies document key board decisions with long-term implications beyond noting them in a board minute. Reflecting such decisions in board or corporate policies reduces reliance on corporate memory. It helps ensure that the necessary parties know and understand the decision, and subject the decision to periodic reassessment.

Where SaskTel is not the sole shareholder, SaskTel depends on shareholder agreements and articles of incorporation to set the company governance structure and expectations. SaskTel must ensure that the agreements and articles of incorporation are sufficiently robust to limit company activities to what SaskTel can do under law. These must also be capable of ensuring that expectations of SaskTel (e.g., that certain information must be made available to the Legislative Assembly) appropriately flow to the company.

Due to confidentiality clauses in shareholder agreements, two companies do not currently give their audited financial results to the Legislative

Assembly even though SaskTel now owns over 90 per cent of each. SaskTel entered into these shareholder agreements when its level of ownership in these companies was significantly lower.

SaskTel has adopted CIC's governance policies for all of its companies even though CIC's policies are designed for only wholly owned companies. In addition, SaskTel has aligned the authority of each company with its own authority. It has made key SaskTel policies, such as final approval policies on spending, applicable to its companies.

Typically, the authority granted to each company is equal or less than that of the most senior member of SaskTel management assigned to its board. This process helps ensure the companies' activities do not exceed SaskTel's powers and authorities. It is notable that SaskTel's policies explicitly apply not only to wholly owned companies, but also to employees and officials who serve on boards of controlled companies that SaskTel does not wholly own.

At the time of our audit, SaskTel had given one wholly owned company spending authority equal to that of SaskTel's President without seeking the required approval of the Board of SaskTel. This delegation was a departure from SaskTel's policy. SaskTel later rectified the delegation.

In addition, SaskTel establishes Governance Teams (comprised of SaskTel staff with specific skill sets) for each company. The Governance Teams work closely with the companies to convey SaskTel's expectations. While SaskTel does not change the composition of the board of the company based on the risks a company faces, it expects the Governance Team to vary the nature and level of its involvement based on this assessment.

At the time of our audit, SaskTel's Board and committees had maintained current and clear terms of reference that included oversight over SaskTel's companies. However, not all the company boards had documented their terms of reference.

SaskTel should ensure that each company board maintains current documented terms of reference. Documented terms of reference permit SaskTel to confirm that its governance expectations are reflected at the companies. At November 30, 2003, SaskTel is in the process of ensuring that all company boards have terms of reference; it expects the process to be complete in 2004.

Assess company board effectiveness

To monitor governance activities at the boards of companies SaskTel owns and controls, we expected SaskTel would identify governance-related risks and would regularly confirm levels of acceptable risk. It would review company governance activities, based upon its assessment of risk. Its review would include evaluating the consistency of company governance with SaskTel's policies and directives.

SaskTel discusses the governance structure of each of its companies with SaskTel's Board. This is typically done when SaskTel makes the initial investment in the company, or when significant changes occur.

SaskTel assesses risks related to the companies. It focuses on the risk of the companies not achieving their approved goal. SaskTel does not explicitly document governance-related risks (e.g., the effect of business risks on the ability to oversee management, quality of board, motivation factors). Explicit documentation of these risks would help SaskTel's Board to challenge whether steps to reduce governance-related risks are adequate and whether the remaining levels of risk are acceptable.

SaskTel uses the Governance Teams to evaluate whether its companies comply with CIC's governance policies. SaskTel reports annually on the companies' compliance to its Board through the Governance Committee. For the companies that it controls but does not fully own, SaskTel has begun to evaluate compliance with CIC's policies. At the time of the audit, the Governance Committee had not yet reviewed this evaluation.

In addition, SaskTel uses its internal audit function to review and evaluate key risk areas for both SaskTel and its companies. Internal audit provides SaskTel management and the Board with independent assessments of risks associated with the companies and, from time to time, with assessments of company governance. Internal audit assessed the governance of two wholly owned companies. Their results are consistent with our findings.

Formal periodic evaluations of senior management and boards help ensure boards and senior management fulfill their roles and responsibilities. SaskTel has processes to formally evaluate its Board and senior management annually.

At November 30, 2003, not all of the companies had a formal evaluation process for their board and senior management. SaskTel is currently in the process of ensuring each company has such a process. It expects evaluations will occur annually. SaskTel has not specified that its Board should receive the results of all company board evaluations. It should do so.

Monitor performance of companies

To monitor the performance of companies SaskTel owns and controls, we expected the following. SaskTel would require regular performance reports. SaskTel would balance the nature, timing, and extent of the information with its assessment of risk. It would review performance information regularly, challenging the quality of information provided by companies.

The SaskTel Board, through its Corporate Growth and Audit Committees, and SaskTel management, through its Executive Committee, both monitor the performance of the companies. The Executive Committee is comprised of SaskTel senior management.

The committees regularly receive and challenge information regarding SaskTel's companies. This includes business plans, risk assessments, and financial and non-financial results. The committees compare actual results to planned results.

These committees monitor risk through quarterly risk assessments. The risk assessments include the activities of the companies and focus on risks that impact SaskTel's ability to achieve its approved plan. The achievement of SaskTel's plan depends on the companies achieving their approved plans.

The risk reports list specific risks and steps taken to lessen those risks. The reports do not describe what levels of risk are acceptable for each company. Thinking about the levels of risk that are acceptable helps agencies decide on what steps are reasonable to reduce specific risks.

In addition, the SaskTel Board's Corporate Growth Committee reviews each company's quarterly financial results and annual financial statements. The Board's Audit Committee also receives these reports to help it fulfil its oversight role. These formal reviews help the Board to monitor the companies' activities and oversee external communications.

SaskTel's senior management balances the nature and timing of company reporting with risk. Where there is more risk associated with the company, senior management requires the company to provide more frequent and extensive information. In addition, when risks increase, the involvement of the related Governance Team increases.

SaskTel's Board and Executive Committee approve the release of money for investment in companies. This approval allows SaskTel to further monitor the activities of the companies and ensure they continue to align with SaskTel's direction.

Take follow-up action to promote consistent governance

To take follow-up action to promote consistent governance, we expected SaskTel would:

- *provide feedback to boards of companies it owns and controls to indicate how the companies should modify their governance practices;*
- *verify that these boards take necessary action; and*
- *make changes, as necessary, to improve governance of these companies.*

SaskTel's senior management, through the Executive Committee, provides regular feedback to the board of each company. With senior management serving as company board members, SaskTel has the opportunity to provide the companies with direct feedback and prescribe corrective action. The President of SaskTel also evaluates SaskTel senior management in their role as company board members.

In addition, the SaskTel Board uses its various committees to provide feedback to the companies, follow up on actions required, and make necessary changes. For example, the Board's Corporate Growth Committee provides advice and feedback on governance structures for companies.

As noted, management's Governance Teams work closely with companies. The Teams provide an additional source of information both to companies about SaskTel's desired changes and to SaskTel about company action in response to SaskTel's guidance.

Formal evaluations of the boards of its companies will provide SaskTel with additional information and insight into company governance practices. It is important that the SaskTel Board receive the results of these evaluations to ensure that necessary adjustments are made.

By making changes to respond to governance risks, SaskTel will promote consistent and effective governance of the companies it owns and controls.

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