

Report on Review of Transportation Governance Models

October 2009



Office of the Comptroller General
Ministry of Finance



**BRITISH
COLUMBIA**
The Best Place on Earth

**Report on Review of Transportation
Governance Models**

Prepared for:

**The Minister of Transportation and
Infrastructure; and**

The Minister of Finance

Office of the Comptroller General

Ministry of Finance

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The Best Place on Earth

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Dear Sir/Madam:

I am honoured to present my office's 2009 review of the Transportation Governance Models.

Cheryl Wenezenki-Yolland, CMA, FCMA
Comptroller General

Victoria, BC
October 2009

Enclosure

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Abbreviations

ASP	Alternative Service Providers
BCFS	British Columbia Ferry Services Inc.
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CPI	Vancouver Consumer Price Index
GRE	Government Reporting Entity
GVRD	Greater Vancouver Regional District
Mayors' Council	The Mayors' Council on Regional Transportation
MFA	Municipal Finance Authority
OCG	Office of the Comptroller General
SkyTrain	British Columbia Rapid Transit Company Ltd.
TB	Treasury Board
the Authority	The BC Ferry Authority
the Commission	The BC Ferry Commission
the Contract	The Coastal Ferry Services Contract
the ministry	The Ministry of Transportation and Infrastructure
the province	The Government of the Province of British Columbia
TransLink	The South Coast British Columbia Transportation Authority
TransLink Commission	The Regional Transportation Commission

Executive Summary

The purpose of this engagement was to review the two independent delivery models, BC Ferry Services Inc. (BCFS) and TransLink, to ensure British Columbians are receiving value for provincially funded grants and investments while meeting the objectives for which the independent models were created.

Our approach included reviewing documentation for both entities, including relevant legislation, agreements, plans, reports, and supporting materials, as well as researching comparable organizations. We also conducted numerous interviews and consultations with members of the Boards, BC Ferry Authority (the Authority), Mayors' Council, the BC Ferry and TransLink Commissions, BCFS and TransLink executives, the Ministry of Transportation and Infrastructure (the ministry) and other stakeholders. We also drew upon expertise from a variety of areas within government.

A New Governance Framework

In both organizations, the governance models should be strengthened to ensure that they meet their public service mandates while protecting the interests of users and taxpayers. As a solution, we have proposed a common governance framework that requires more accountability from the companies and their Boards, stronger oversight by the groups who are effectively the operating companies' shareholders, and stronger roles for the Commissions. The framework envisions the shareholder groups as being independent of the companies and their Boards and as having mandates to protect ratepayers' interests and service levels, to improve transparency and public accountability for decisions and performance levels, and to minimize costs and maximize benefits to taxpayers.

BC Ferries

With the exception of compensation, we found BCFS' operations to be well managed and reasonably effective, while the current governance framework has the components to be effective, the implementation and the decisions made by parties suggest improvements are required to ensure strong oversight and accountability.

The BC Ferry Authority, which holds the single outstanding common share of BCFS, should act as a shareholder by having oversight for and requiring accountability from the BCFS Board of Directors. However, the members of the Authority have followed the practice of appointing all 9 of its members to the 13-member BCFS Board. Due to the inherent conflict, we recommend this practice be discontinued. To strengthen the governance model, the Authority must be independent from the BCFS Board and should oversee the Board.

BCFS executive compensation was significantly higher than that paid by several larger public sector entities. For example, the Chief Executive Officer's (CEO) total 2008/09 compensation was more than double that of the larger public sector comparators. We also found that the performance measures and targets used to determine the incentive bonuses for executives' made the bonuses easier to attain than we would have expected.

The BCFS Board Directors' remuneration was also higher than public sector organizations we compared against, and the retainer fee portion, which was most of the remuneration, was three to five times higher than permitted under a Treasury Board (TB) directive governing BC Crown Corporation Board compensation (although BCFS is not obligated to abide by TB directives because it is not a Crown Corporation).

Our concerns regarding BCFS' compensation are compounded by the fact the BCFS Board sets its own compensation and approves the executive compensation without accountability to the independent Authority (shareholder).

In reviewing BCFS' operations, we found appropriate financial and management controls and processes established including planning, budgeting, monitoring, reporting, internal controls, a capital asset management framework, procurement policies, and an active internal audit function. The company demonstrated that cost containment strategies, revenue generating efforts and customer service quality systems were in place.

We noted that the legislation defines 6 key principles for the Commission to consider in its work. The legislation goes further to guide the Commission to prioritize the sustainability of the ferry operator. While it may not have been the intention, this prioritization has resulted in the Commission taking a very narrow interpretation of the principles and the regulatory role. In particular, we would expect the Commission to focus as well on the sustainability of the coastal ferry system, balancing the financial sustainability of the system with the needs of customers, the operators and the communities. As a result, we have recommended changes in the Commission's mandate and responsibilities.

The role fulfilled by the Ferry Commission should be broadened to include a number of additional responsibilities including the regulatory functions of protecting customers' interests, commenting publicly on various aspects of BCFS, plans and operations, and regulating reservation fee and any competitive services BCFS provides such as drop-trailer transportation. In addition, the Commission should do more independent verification of information it receives from BCFS.

We have also recommended that BCFS, with public input, periodically re-evaluate the route service levels, that the Ferry Commission independently evaluate BCFS' service plans, and that the province consider that information when re-assessing the contracted service levels with a view to obtaining better value from the service fees paid by the province.

TransLink

At the time of our review the current governance structure for TransLink had only been in place for about a year and a half. While this is considered a transition period, we found significant operational issues that have gone unaddressed in the years preceding the governance change. Inaction by TransLink and the Mayors' Council to maintain a balance between expenses and revenues has brought TransLink to a point at which substantial operating deficits in 2010 and beyond will be difficult to avoid (a structural deficit).

Uncertainty regarding the new roles and responsibilities, and the conflicting interests amongst parties has also contributed to the limited progress towards resolution of the structural deficit. Avenues for increased communication and a forum to allow for building of shared priorities needs to be created thus strengthening overall accountability and resolving the residual uncertainty.

In comparing the current TransLink governance model to the proposed common governance framework we identified a number of opportunities to enhance the defined roles of the Mayors' Council, the Commission and the Province. To facilitate active involvement and strategic alignment among the government bodies we have recommended there be some provincial representation (max. 20%) at the Mayors' Council and that this group be renamed the Transit Authority to better reflect its broader membership.

The appropriate role of the Mayors' Council/Transit Authority is to serve as the proxy shareholder/overseer of the TransLink Board of Directors. To fulfill that role, the Mayors' Council/Transit Authority should be more fully given responsibility for Board appointments, setting Board remuneration and overseeing the Board, while not assuming management's role. The Mayors' Council/Authority will need to embrace their responsibility to provide for a Transit system that not only provides the highest quality of service, but remains financially sustainable.

In recent years, TransLink has undertaken a strategy of significant expansion. As a result of inaction on the parts of TransLink and the mayors, the Authority is facing a significant operating deficit (in excess of \$130 million annually) due to its inability to fund the increased operating expenses and carrying costs of the larger system. Cost containment measures so far have been minimal and insufficient to alleviate the financial challenges caused by growing the system without revenue sources being fully planned. As they are ultimately responsible for their own financial well being, earlier actions should have been taken by TransLink to contain rising costs through service rationalizations and other means to mitigate or prevent the known structural deficit that was being predicted.

We found the TransLink Board has recently made progress towards adopting a business-like approach by providing TransLink staff with clear direction in areas such as capital spending, customer focus, enhanced revenue and improved reporting. We also noted improvements in environmental initiatives and strong transparency and public consultation.

The TransLink Board will need to focus their attentions to aggressive and meaningful cost containment strategies, full exploitation of available revenue streams and a rational approach to service provision in order to lead the organization back to financial sustainability.

The size and composition of the TransLink Board is reasonable and their compensation just slightly high. The appointment process and compensation of TransLink's executive is reasonable but the total number of executive in TransLink and its subsidiaries is excessive.

The Regional Transportation Commission (the TransLink Commission) should have more powers and responsibilities to regulate TransLink. We have made recommendations to strengthen the role of the Commission by extending its mandate to include overseeing costs and service levels and by requiring more assessment and verification of TransLink's information and strategies.

We have also provided other recommendations regarding the planning framework, exploitation of revenue streams, exploration of alternative sources of revenue, conducting service rationalizations, review and minimization of costs and for clear articulation by the ministry of its regional transportation priorities.

Regulator

We propose that the province explore the potential of having one Transportation Commission oversee BCFS and TransLink. This would parallel other regulated sectors such as the BC Utilities Commission that regulates natural gas and electricity utilities, intra-provincial pipelines and other areas. A properly resourced, larger Transportation Commission with a broader mandate would be in a position to provide a stronger, more consistent regulatory approach to these vital transportation systems.

Government Control

When dealing with government-created independent entities, the government always has the option of bringing these entities into the Government Reporting Entity (GRE), under government control, if the entity is considered to be insufficiently fulfilling the province's public service mandate or inadequately meeting the needs of users and taxpayers.

There would be a number of positive and negative implications of such a decision. We have not identified and assessed those implications as that was outside of the scope of this review. In keeping with the purpose and objectives of our review, our report assumes that BC Ferries and TransLink will continue as government-created independent models into the future.

We would like to thank the management and staff of BCFS, TransLink, the BC Ferry and TransLink Commissions, members of the Boards, the Authority, the Mayors' Council, the Ministry of Transportation and Infrastructure and other stakeholders who participated in and contributed to this review for their co-operation and assistance.

A handwritten signature in blue ink, appearing to read 'Cheryl Wenezenki-Yolland', written in a cursive style.

Cheryl Wenezenki-Yolland, CMA, FCMA
Comptroller General
Ministry of Finance

Introduction

In this report, BC Ferries refers to BC Ferry Services Inc. (BCFS), the BC Ferry Authority (the Authority) and the BC Ferry Commission (the Commission) as a whole. TransLink refers to the South Coast British Columbia Transportation Authority (TransLink) and its subsidiaries. The governance model for TransLink includes TransLink itself, the Mayors' Council on Regional Transportation (the Mayors' Council) and the Regional Transportation Commission (the TransLink Commission).

The Ministry of Transportation and Infrastructure's (the ministry) provincial transportation strategy integrates the various modes of transportation across the province in order to open up BC and safely move people and goods. The coastal ferry system and Metro Vancouver's public transportation system and infrastructure are integral components of the ministry's provincial transportation strategy. BCFS and TransLink, respectively, are responsible for these two important systems.

The current BCFS governance model was established under the *Coastal Ferry Act in 2003*, with the objectives of strengthening the governance and long-term sustainability of the ferry system and allowing it to operate commercially and free of political interference.

The TransLink governance model, established in 1999, was revised in 2007 under *the South Coast British Columbia Transportation Authority Act*, providing for a regional transportation system that supports regional growth, environmental objectives and economic development of its service region.

Both governance structures include regulation of specific aspects of the structures and operations by publicly appointed independent Commissions. The BC Ferry Commission regulates fares and service levels. The TransLink Commission regulates the long-term transportation and financial plans, short-term fares, sale of assets, and processes with respect to customer satisfaction and complaints.

Both governance models include separate bodies that appoint the operating companies' Boards of Directors. In the case of BC Ferries, the Authority, which consists of nine members including representatives from coastal communities, the union, and the province, holds the single common share of BCFS. In the case of TransLink, the Mayors' Council, which includes the transportation service region's 21 mayors and one First Nations band chief, appoints both TransLink's Board and the TransLink Commission.

Purpose

The purpose of this engagement was to review the two independent delivery models, BC Ferries and TransLink, to ensure British Columbians are receiving value for provincially funded grants and investments while meeting the objectives for which the independent models were created.

Objectives and Scope

The engagement was to assess the following aspects of the models to ensure their ability to meet their intended objectives:

- The division of responsibility between the province, the respective entities, commissions and authorities.
- The size, composition, appointment process and compensation for the Board of Directors and Executive of the Authority, BCFS, as well as the South Coast British Columbia Transportation Authority and their respective commissioners.
- The regulatory environment, including responsibilities, authorities, powers and compensation of the Ferry Commission as well as the Regional Transportation Commission and the Mayors' Council on Regional Transportation.
- The operating costs and service delivery models, including the company's efforts to reduce costs using Alternative Service Providers (ASPs) and actions to increase productivity and quality customer service.

In addition, the engagement was to review options available to the province that are consistent with the entities' independence under generally accepted accounting principles (GAAP) and which would ensure that existing and future independent, regulated, publicly created authorities such as BCFS and the South Coast British Columbia Transportation Authority are effectively structured to:

- 1) Protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for executives and Board members;
- 2) Protect clearly mandated customer service levels;
- 3) Minimize cost and maximize benefits to BC taxpayers of provincially funded grants; and
- 4) Improve transparency and public accountability for decisions and performance levels.

The terms of reference for this review noted that the review might also identify areas where further examination is warranted.

Approach

The assignment was conducted by a multi-disciplinary team from various branches within the Office of the Comptroller General (OCG). Our review of the two organizations was conducted over a period of eight weeks. To allow for completion of the work within this timeframe we conducted a broad scan of each model, performing in depth work where we observed gaps, possible concerns or opportunities for improvement. Our approach involved:

- Review of relevant legislation, contracts, agreements and other documentation;
- Interviews and consultation with members of the Boards, Authority, Mayors' Council, the Commissions, senior company executives, the province and other stakeholders;
- Consultation with the Board Resourcing Development Office, the Public Sector Employers' Council Secretariat, and Crown Agencies Secretariat;
- Review and consideration of voluntary submissions from stakeholders;
- Research for comparable information from other relevant organizations and other jurisdictions;
- Research on best practices in governance from expert and professional sources;
- Review of recent annual reports of the entities; and
- Review of the relevant recent reports of the BC Office of the Auditor General and both the BC Ferry Commission and the Regional Transportation Commission.

1.0 A Framework for Transportation Governance

Comments and Recommendations

Through our review of the BC Ferries and TransLink governance models we identified key components of a framework that could guide future applications of independent, regulated, publicly created authorities so that they are effectively structured to fulfill the following four principles:

- 1) Protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members.
- 2) Protect clearly mandated customer service levels.
- 3) Minimize cost and maximize benefits to BC taxpayers of provincially funded grants.
- 4) Improve transparency and public accountability for decisions and performance levels.

The components of the framework would provide accountability and protection of the province's and the taxpayers' interests.

This governance framework was the basis for our recommendations regarding BC Ferries and TransLink. We suggest the province consider this framework in establishing governance structures for other applications and if modifying the BC Ferries and TransLink models in future.

Subsections 1.1 to 1.3 discuss basic principles of the framework. Diagram 1A in section 1.3 presents a schematic of the framework, and Appendix 1 explains the roles and responsibilities of each of the key framework components and additional mechanisms for protection of government and taxpayer interests.

1.1 A Shareholder Group

An essential element of the governance framework is a body to oversee and hold accountable the operating company's Board of Directors. This body is given a mandate to fulfill responsibilities that parallel those of corporate shareholders. In the case of BC Ferries and TransLink, the shareholder/overseer should be the Authority and the Mayors' Council, respectively.

The roles and responsibilities of the shareholder/overseer group need to be explicit, clear, and mandated in legislation. They also need to provide for the necessary tensions between the needs of the company, the customers and taxpayers.

The shareholder/overseer group should be selected through a process that ensures the group will understand and maintain this balance. There needs to be a clear distinction between this group's role and the role of the operating company's Board of Directors.

The shareholder/overseer group should be responsible for overseeing the Board, providing broad policy direction, and holding the Board accountable. The group would appoint, evaluate and, if necessary, remove Board Directors and establish their remuneration.

1.2 A Regulator

Another important element of the framework is an independently appointed regulator with the appropriate powers and scope of responsibility. The regulator's range of scope, mandated under legislation, should be broader than those of the regulators of BCFS and TransLink at present.

The regulator's statutory role needs to be broad enough to include protecting the interests of ratepayers and customers balanced with the financial and operational sustainability of the regulated organization.

The parallels we observed between the BC Ferries and TransLink governance models and their issues needing improvement lead us to suggest that the province explore the potential of establishing one Transportation Commission to oversee both entities. This would be similar to other regulated sectors such as the BC Utilities Commission that regulates natural gas and electricity utilities, intra-provincial pipelines and other areas. A single, larger Transportation Commission, with a stronger mandate and properly resourced, should enable a stronger, more consistent approach to the regulation of these vital transportation systems.

Recommendation

- 1) **We recommend the province consider establishing a single regulating entity for the transportation sector including BC Ferries, TransLink and other entities considered appropriate.**

1.3 Government Control

When dealing with government-created independent entities, the government always has the option of bringing these entities into the Government Reporting Entity (GRE), under government control, if the entity is considered to be insufficiently fulfilling the province's public service mandate or inadequately meeting the needs of users and taxpayers.

While BC Ferries has shown to be functioning quite well, with a few exceptions, TransLink has had its model reviewed and changes made on more than one occasion. Given this history and that TransLink has a more complicated governance structure, the province could consider bringing it into the GRE if it has not been able to be more effective at meeting the needs of users and taxpayers after implementing the recommendations in this report.

There would be a number of positive and negative implications of such a decision. We have not identified and assessed those implications as that was outside of the scope of this review. In keeping with the purpose and objectives of our review, our report assumes that BC Ferries and TransLink will continue as government-created independent models into the future.

Diagram 1A - Broad Governance Roles and Responsibilities

Diagram 1A and Appendix 1 together explain the broad governance roles and responsibilities of each component of the proposed governance framework for any future independent, regulated, publicly created organizations as well as for BC Ferries and TransLink.

Recommendation

- 2) **We recommend the province consider using the proposed governance framework as a model for establishing any future independent, regulated, publicly created organizations.**

	CROWN (example)	BC FERRIES	TRANSLINK	PRIVATE (example)
Shareholder / Overseer	Ministry of Energy, Mines & Petroleum Resources	BC Ferry Authority	Mayors' Council	Shareholders
Operating Entity	BC Hydro	BC Ferry Services	TransLink & Subsidiaries	Terasen Gas
Regulator	BC Utilities Commission	BC Ferry Commission	Regional Transportation (TransLink) Commission	BC Utilities Commission
Mechanisms for protecting government / taxpayer interests	<ul style="list-style-type: none"> ✓ Direct control by government as shareholder 	<ul style="list-style-type: none"> ✓ Performance-based contract where funding provided. ✓ Legislative or regulatory requirements (e.g., safety, environmental, land use, labour, consultation, public disclosure, etc.) ✓ Negotiate and collaborate based on shared interests. ✓ Public policy as reflected in such things as long-term economic and capital infrastructure plans and initiatives. 		

2.0 BC Ferries – Overview

BCFS operates coastal ferry services under the terms set out in the 2003 Coastal Ferry Services Contract (the Contract), a 60-year service contract with the Province of BC.

Through this contract, the government pays BCFS a defined service fee (approximately \$125 million annually) in return for providing defined numbers of ferry sailings during specified hours on all BCFS routes. The three routes between Vancouver Island and the BC Lower Mainland, known as the major routes, are collectively self-supporting and receive no service fee from provincial taxpayer funds.

The service levels required and the service fees to be paid under this long-term contract are to be reviewed each four year performance term. The next review is due in 2012.

In 2003, BC Ferries was changed from a taxpayer supported Crown Corporation to a company under the *BC Companies Act*. To support a sustainable coastal ferry system, a new model, governed by the *Coastal Ferry Act* (the *Act*), was developed to create a company that could attract private-sector investment and adopt a commercial approach to service delivery that responds to the marketplace, minimizes costs to the taxpayer and improves customer service and choice.

The key components of the new Coastal Ferries model, which form the governance structure for BCFS, are:

- The BC Ferry Authority;
- BC Ferry Services Inc. (including its Board of Directors);
- The BC Ferry Commission;
- The Ministry of Transportation and Infrastructure;
- Other federal, provincial, municipal government bodies;
- The Coastal Ferry Services Contract; and
- The *Coastal Ferry Act*.

In this model, BCFS is controlled by the BC Ferry Authority through the Authority's ownership of the single common voting share of BCFS. The Authority appoints the BCFS Board of Directors.

This structure was intended to ensure the operations of BCFS are independent from the Provincial Government.

BCFS is regulated by the Ferries Commission to ensure that rates are within the fare price caps set by the Commission and to monitor whether service levels comply with the Contract.

The services of BCFS link Vancouver Island to the BC mainland and connect many isolated coastal communities to either Vancouver Island or the mainland. The 36 BCFS vessels travel between 47 terminals on 25 routes. In fiscal 2009, BCFS provided more than 187,000 sailings carrying 20.7 million passengers and 8.1 million vehicles. The company's workforce consists of unionized and management employees, including 2,800 full-time workers and 1,700 casual, on-call employees.

3.0 Governance – BC Ferries

We reviewed the following aspects of the BCFS governance model to ensure their ability to support the intended objectives:

- The division of responsibility between the province, BCFS, the Authority and the Commission.
- The regulatory environment, including responsibilities, authorities, and powers of the Commission.

Overall, we found the government-created independent governance model with its regulatory environment and division of responsibilities, as applied to BC Ferries requires strengthening. While the current governance framework has the components to be effective, the implementation and the decisions made by parties suggest improvements are required to ensure strong oversight and accountability. The principles and the roles identified in legislation also need to be broadened and clarified to focus on achieving all of the currently identified objectives.

Oversight over BCFS and BCFS accountability are inadequate because Authority members have also appointed themselves as Directors on the BCFS Board. Consequently, the Board approved excessive compensation plans for both themselves and the BCFS executives without proper accountability. Also, the Commission's role as defined in the *Act* and interpreted by the Commission is not broad enough to adequately protect the public service mandate of the ferry system.

The focus on the sustainability of the ferry operator(s), articulated in the *Act* as a principle to guide the Commission, needs to be balanced with the interests of users of the ferry system, local communities and taxpayers to ensure the long term sustainability of the transportation system.

3.1 The Intended Objectives

Identifying the Objectives

While the province's objectives for the model when it was created were believed to be clear, six years of experience with the model have highlighted other objectives which should be incorporated into the *Act*.

The *Act* provides six principles to guide the Commission's work. Those principles, which provide some indication of the province's intentions, are:

- Priority is to be placed on the financial sustainability of the ferry operators;
- Ferry operators are to be encouraged to adopt a commercial approach to ferry service delivery;
- Ferry operators are to be encouraged to seek additional or alternative service providers on designated ferry routes through fair and open competitive processes;
- Ferry operators are to be encouraged to minimize expenses without adversely affecting their safe compliance with core ferry services;
- Cross subsidization from major routes to other designated ferry routes is to be eliminated within the first performance term of the first Contract to be entered into under this *Act*, and before its elimination, to be minimized; and
- The designated ferry routes are to move towards a greater reliance on a user pay system so as to reduce, over time, the service fee contributions by the government.

The office of the BC Auditor General, in preparing their December 2006 report 'Changing Course – A New Direction for BC's Coastal Ferry System', sought to determine the intended objectives. They referred to those six principles and the *Act* itself, but found they needed to also consult *Hansard*, press releases, and members of the 2003 transformation steering committee. The Auditor General concluded there were five main objectives aligned around two overall intentions, as follows:

"To improve governance by:

- 1) separating public policy decisions from operating and financing decisions of the ferry system; and
- 2) making the cost of the ferry system transparent to the taxpayer.

To ensure long-term sustainability by:

- 3) minimizing the cost of the ferry system to the taxpayer by reducing costs and shifting a larger share of those costs to ferry users;
- 4) protecting the ferry system in the long term; and
- 5) improving service to the customer.”

The terms of reference for our review indicates that the province, has a core set of objectives it would like to see achieved by all independent, regulated, publicly created organizations including:

- 1) protecting ratepayers’ interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members;
- 2) protecting clearly mandated customer service levels;
- 3) minimizing costs and maximize benefits to BC taxpayers of provincially funded grants; and
- 4) improving transparency and public accountability for decisions and performance levels.

Throughout our review, we have assumed that those four principles, along with the original objectives, are the province’s present intended objectives for the BC Ferries governance model.

Concerns with the Intentions

The province’s current intentions for the BC Ferries governance structure need clarification. For example, recognition of ferry users’ desire to minimize fare increases was notably absent from the intended objectives, though it was included in the core objectives for this review. Conversely, the stated intention in the *Act* to shift a larger share of costs to the users led in the opposite direction. Fares have increased, and some ferry users have expressed their displeasure with that. Also, the principle of eliminating cross-subsidization from the major routes to the other routes puts upward pressure on the other routes’ fares.

The Commissioner noted that his primary objective is to ensure the financial sustainability of BCFS (the operator), as the guiding principles in the *Act* require. The *Act* defines six key principles for the Commission to consider in its work. While the degree of emphasis on that objective may not have been the intention, this prioritization of the objectives has resulted in the Commission taking a very narrow interpretation of the principles and the regulatory role.

In consideration of a viable ferry system we, like the Auditor General, would expect the province’s objectives to include the long-term sustainability of the BC coastal ferry transportation system as a whole.

There is a risk that a focus on the profitability or sustainability of the ferry operator exclusively could be at the expense of the public service mandate of the ferry system. For example, short term decisions, focused on maximizing profit to the operator, could compromise the public service goals of the ferry system by not considering fully the interests of users of the ferry system, local communities and taxpayers.

To ensure appropriate attention is placed on all intended objectives the province should clarify its expectations, communicate them publicly, and ensure they are incorporated clearly in the BC Ferries governance framework and corresponding legislation. This would provide all stakeholders with an improved understanding of the model.

It would also aid with clarifying the intended roles of the Authority, the Commission and BCFS, and it would provide a sound basis for evaluation of the model's performance.

Recommendation

- 3) **We recommend the province review, clarify and update the legislation to reflect fully its current intentions and objectives for the coastal ferry system governance model.**

3.2 The BC Ferry Authority

To ensure strong accountability and oversight of BCFS is maintained, the Authority should be independent of the BCFS Board, but it is not, as the Authority members have appointed themselves to the BCFS Board. Consequently, the Authority has not fulfilled its proper function as a shareholder.

The Authority's role in the governance framework needs strengthening; the Authority needs to act as a shareholder. As controlling shareholder of BCFS, the Authority needs to maintain independence from the Board and management in order to fulfill the normal functions of shareholders such as:

- appointing and, if necessary, removing Directors of the BCFS Board;
- establishing the remuneration and terms of service of the BCFS Board members;
- overseeing and providing broad strategic direction to the BCFS Board; and
- reviewing long-term, strategic and direction-setting plans and policy proposals from the BCFS Board and management.

The Authority has not maintained the necessary independence and has not fulfilled such shareholder functions. Since 2003, the Authority has followed a practice of appointing all nine of its members to serve also as members of the BCFS Board. As a result, the Authority members comprise a clear majority of the BCFS Board, holding 9 of the current 13 seats.

The Authority members have thus placed themselves in a position of conflict of interest because the interests of the Authority as shareholder are not identical to the interests of BCFS. As a result, the Authority's proper role as overseer of BCFS has been compromised. The absence of independent oversight of BCFS by the Authority weakens accountability and increases the risk that the company's spending and priorities may not be acceptable to its shareholders.

Recommendations

4) **We recommend the province amend the legislation to:**

- **require that Authority members be independent from BCFS and its Board members; and**
- **expand the Authority's mandate to include shareholder functions such as providing broad strategic direction to the BCFS Board; overseeing the BCFS Board; establishing the remuneration and terms of service of the BCFS Board members; and reviewing and approving or rejecting long-term, strategic and direction setting proposals from the BCFS Board and management.**

3.3 The BC Ferry Commission

The Commission's role as defined in the Act and interpreted by the Commission is not broad enough to adequately protect the public service mandate of the ferry system. The Commission monitors BCFS' compliance with the service levels required by the terms of the Contract for each route including hours of operation, number of sailings and adherence to scheduled sailing times. We support continuation of this good practice.

The province has the opportunity to strengthen the Commission's role to better support the four principles defined for this review.

The Commission is the regulator of ferry services and fares. A regulator's role would normally include protecting the interests of customers in balance with protecting the financial and operational sustainability of the regulated organization. Protection of ferry customers' interests is not explicitly required of the Commission.

As noted in subsection 3.1, the guiding principles provided in the *Act* to guide the Commission do not mention customers. In the present governance model there is no independent body with the responsibility for dealing with customers' complaints. It may be that this role could best be served by the Commission or by a separate body or individual. Alternatively, consideration could be given to a role similar to that carried out by the TransLink Commission in this regard.

Currently the Commission does not comment about the mandatory contracted service levels. The Commission's review is limited to monitoring for compliance. A broader review with consideration of the need for balance between capacity, cost and service levels may create useful public discussion and awareness.

The Commission's present role does not include considering the implications of BCFS' long-term and strategic plans and broad policy direction on future fares and provincial/federal service fees. The Commission's overseeing of BCFS and its fare levels are limited to the four-year performance terms of the Contract.

The role of taking this longer view is important and is best filled by the Commission. Further, the Commission should express its views on BCFS' plans and direction publicly.

The ferry system and its stakeholders would benefit if the Commission's role also included assessing and commenting publicly on:

- BC Ferries service levels. Currently the Commission does not comment about the mandatory contracted service levels. The Commission's review is limited to monitoring for compliance. A broader review with consideration of the need for balance between capacity, cost and service levels may create useful public discussion and awareness.
- the reasonableness of BCFS' operating and capital costs;
- BCFS' efforts to control costs and maximize revenues from sources other than fares;
- the fairness of BCFS' detailed allocations of costs among its routes; and
- the fairness of its management of fuel surcharges and rebates.

The Commissioner noted that the requirement that BCFS seek alternative ferry service providers to foster competition and cost efficiency could be better enforced if the Commission were given the authority to approve BCFS' alternative service provider plans for each performance period and to monitor BCFS' efforts and process for seeking and selecting alternative providers.

The Commissioner acknowledged that the Commission does little verification of information it receives from BCFS and uses for establishing and monitoring fare price caps and for other purposes, though it has the authority to do so.

It is essential that key information received from BCFS be reliable because it is the basis for fares, and, in turn, fares directly affect BCFS' bottom line and the level of the service fees paid by the province. Therefore, the Commission should apply an appropriate level of verification, at least periodically, to information provided by BCFS. Certification of key information by BCFS management would support reliability.

Reservation fees are not regulated currently because they are considered to be ancillary revenues rather than an element of fares. Reservation fees are directly related to the service of transporting vehicles and passengers and, as such, are effectively part of the fares and, therefore, should be regulated.

The governance model provides no regulation of services BCFS may provide that compete directly with private enterprise. For example, BCFS recently entered into the 'drop trailer' market. Truck trailers can be dropped off at a ferry terminal and BCFS will load and deliver them to their destination ferry terminal. This presents direct competition to private operations that provide similar services. While this is consistent with the entrepreneurial behavior to be expected of a commercial enterprise, it could be perceived that BCFS has undue advantages such as having exclusive use of the ferry terminals, having a monopoly on ferry services and receiving funds from the provincial and federal governments. To avoid the possibility that passenger fares could be allocated an unfair portion of the costs, and to ensure there is no perception of undue advantage, it is important that the allocation of costs between such commercial services and passenger/vehicle services be transparent and subject to independent oversight. To this end, the Commission should regulate such competitive services separately from its regulation of the transportation of vehicles and passengers in order to avoid impacting regulated fares under the price cap model.

In addition, the Commission could support the effectiveness of the Authority by commenting publicly on the Authority's performance in discharging its legislated responsibilities.

Recommendations

- 5) **We recommend the province consider amending the legislation to change the Commission's required responsibilities to include:**
 - **a seventh guiding principle, protecting the interests of ratepayers and customers;**

- **protecting consumer interests and ensuring effective management of customers' complaints;**
 - **regulating competitive services (such as BCFS' 'drop trailer' service) separately from its regulation of the transportation of vehicles and passengers;**
 - **regulating reservation fees, considering those fees to be effectively part of the fares for transportation of passengers and vehicles;**
 - **assessing and commenting publicly on:**
 - **10 to 15 year strategic and capital BCFS plans and their implications for future services, fares and provincial/federal service fees;**
 - **The reasonableness of the levels and nature of BCFS' operating and capital costs;**
 - **BCFS' efforts to control costs and maximize revenues from sources other than fares;**
 - **The fairness of BCFS' allocations of costs among its routes and its management of fuel surcharges and rebates;**
 - **BCFS' plans to seek Alternative Service Providers (ASPs) and their processes for choosing the routes for which to solicit ASPs, for soliciting ASPs and for selecting among ASP proposals received; and**
 - **BCFS' service levels and standards with consideration of the need for balance among capacity, cost and service levels.**
 - **applying increased verification procedures to the information provided the Commission by BCFS to ensure its validity (particularly financial and service level reports); and**
 - **issuing an annual public opinion on the performance of the Ferry Authority in carrying out their legislated responsibilities and accountabilities (i.e. Board appointments, overseeing the Board, approval of compensation plans, etc).**
-

3.4 Transparency and Accountability

One of the original intentions of the model was to improve governance by making the cost of the ferry system transparent to the taxpayers. The websites of both BCFS and the Commission provide the public with substantial information about BCFS' financial and operating performance including annual reports, price caps, required service levels and BCFS' performance in maintaining those service levels.

However, there is room for improvement of BCFS' transparency and accountability. Currently, BCFS and the Authority are not subject to the *Freedom of Information and Protection of Privacy Act*. BCFS does not provide information on the detailed costs of operating individual routes. Interested stakeholders felt that BCFS should be required to make public more detail of its actual allocations of its costs among the routes. BCFS informed us they are reluctant to do so on the grounds that doing so could give too much information to potential alternative ferry service providers/competitors and could result in conflicts among ferry users' groups.

In addition, we noted the Commission's website invites public comment and explains that comments can lead to probes by the Commission. However, more public input could be generated if the opportunities for input was more widely promoted by, for example, print media displayed on board ferries.

Recommendations

6) **We recommend the province:**

- **consider making BCFS and the BC Ferry Authority, including the compensation they pay, subject to the Freedom of Information and Protection of Privacy Act;**
 - **require BC Ferries to provide the Commission their methodology for allocating costs among its routes for price cap calculation purposes by major cost category along with the resulting cost allocations by route. The Commission should make this information public. BC Ferries could decide to proactively release this information as well; and**
 - **consider amending the legislation to change the Commission's required responsibilities to include ensuring the public is kept aware they can provide the Commission their views and concerns about BCFS' operations and performance through such vehicles as public hearings or written submissions.**
-

4.0 Size, Composition, Appointment Processes and Compensation – BC Ferries

We found the compensation of the BCFS Board and BCFS executive is excessive. We reviewed the size, composition, appointment process and compensation for the BCFS Board of Directors, the BCFS executive, the BCFS Authority and the Commission to ensure their ability to support the intended objectives. We found aspects that could be improved to better support the apparent intended objectives of the BC Ferries governance model.

Our approach in this section included comparisons to other organizations. BCFS operates primarily in a monopoly environment and is a private company only because the province structured it in that way. Therefore, the best comparators are public sector organizations operating in similar monopolistic environments.

4.1 The BCFS Board of Directors – Size, Composition & Appointment Process

The Articles of BCFS permit up to 20 Directors on the BCFS Board. Currently there are 13. Best practice suggests the most effective size for such a Board would be nine to eleven Directors, as larger Boards can slow decision-making and reduce a Board's effectiveness.

The BCFS Board is larger than the Boards of BC Hydro (10), BC Investment Management Corporation (7), the Insurance Corporation of BC (9) and Port Metro Vancouver (11).

As the sole voting shareholder of BCFS, the Authority appoints the Directors of the BCFS Board. Since the inception of the governance model in 2003, the Authority has appointed each of its nine members to the BCFS Board along with others it considered necessary to ensure the BCFS Board had the necessary knowledge, skills and abilities. However, we have recommended above that appointment of Authority members to the BCFS Board cease. That would result in nine vacancies on the BCFS Board, creating an opportunity for the Authority to appoint a carefully selected group of individuals with the proven skills and abilities to provide professional direction for BCFS.

The Authority uses, and should be required to continue to use, competency-based criteria for selection of BCFS Board Directors.

Recommendation

-
- 7) **We recommend the province amend the legislation to require that the Authority use competency-based criteria for the selection of members of the BCFS Board.**
-

Also, we suggest the province strongly encourage BCFS to amend its Articles to reduce the maximum number of Directors from 20 to a number more consistent with other public sector and private businesses of comparable size and complexity.

CEO
A Director

In 2005, the BCFS Chief Executive Officer (CEO) was appointed a voting Director of the BCFS Board. While the *Act* does not expressly prohibit appointment of the CEO to the Board, a Board needs to maintain independence from their CEO and other executive to support the governance model that separates the roles and responsibilities of the Board and management and to allow the Board to properly fulfill their roles of assessing the CEO's plans and evaluating, compensating and, if necessary, replacing the CEO.

A CEO would generally attend Board meetings as a matter of course, but the Board's independence from management is at risk of being compromised if the CEO or another executive is a voting Board member.

Recommendation

- 8) **We recommend the province amend the legislation to require that the BCFS CEO and other executive not be members of the Authority or voting members of the BCFS Board.**

4.2 BCFS Board Compensation

We have identified a number of concerns related to Board compensation including excessive remuneration, lack of accountability, and flaws in the process for setting remuneration levels.

First, the BCFS Board establishes its own compensation, without accountability to anyone for the level of compensation it sets for itself. Since all Authority members are directors on the BCFS Board, Board members are effectively accountable to themselves. Accountability is an important control, but effective accountability requires separation between the Authority and Board members. Therefore, as noted above, we are recommending that Authority members not be on the BCFS Board and the Authority be responsible for establishing the Board's remuneration.

Second, the process for establishing the Board's compensation was flawed. The terms of reference of the BCFS Board's Governance and Nominating Committee sets out the process by which the Board is to establish its compensation. Benchmarking against comparables is required, but no criteria are specified for identifying reasonably comparable organizations. As well, we noted the Board and executive management had significant input into the selection of the comparators an external consultant used in a 2007 benchmarking process for both Board and executive compensation. The extent of their input draws into question the independence of the benchmarking process.

Our third concern was that the 17 comparators used in the 2007 benchmarking process were less than ideal as most were substantially larger organizations than BCFS. Average sales and assets of the comparators were both approximately five times larger than those of BCFS. Also, twelve of the seventeen comparators were publicly traded corporations operating in competitive markets, while only four were public sector organizations.

Finally, we found the remuneration of the Chair and Directors to be excessive. For 2008/09, the Chair's remuneration was approximately \$154,000, and the other Directors who were involved for the full year received remuneration that ranged approximately from \$67,000 to \$91,000.

The remuneration consists of retainer fees of \$140,000 for the Chair and \$48,000 for Directors, additional smaller retainers for committee Chairs and committee members, and per diem meeting fees. The CEO does not receive any additional compensation for acting as a Board Director beyond what he receives as President and CEO.

The Board's compensation was higher than was paid the Boards of comparable public sector organizations: BC Hydro, ICBC, WorkSafe BC, Port Metro Vancouver and the Vancouver International Airport Authority. The retainer fees are also three to five times the amounts set out in a provincial Treasury Board directive to Crowns. While that directive does not apply to BCFS, we would not expect BCFS to vary so much from the levels the directive specifies.

As stated in subsection 3.2 above, we recommend that the Authority establish the remuneration of the BCFS Board.

4.3 BCFS Executive Size, Composition, Appointment Process & Compensation

Size, Composition and Appointment Process

The size, composition and appointment process of the BCFS executive is reasonable given the size, nature and complexity of BCFS' operations. The executive team consists of the CEO and three executive vice-presidents. The Board hires the CEO and the CEO, in turn, leads the selection of the executive vice-presidents and obtains Board approval.

Executive Compensation

Overall, we found the compensation of the BCFS executive excessive. We also identified concerns related to the compensation-setting process including issues regarding performance measures for the annual incentive bonuses, and flaws in the process for comparing BCFS' executive compensation with that of other organizations.

BCFS' compensation program for executive includes base salary, annual and long-term incentive plans, and a pension element. For 2008/09, the base salary component comprised between approximately 48% and 57% of total compensation.

The compensation of the CEO and the other executive is determined by the Board with guidance from its Human Resources and Compensation Committee. Every two years, the Committee reviews the executive compensation program using a process that includes engaging a consultant to benchmark against other organizations.

The annual and long-term incentive plan payments are based on achievement of performance measures. The Human Resources and Compensation Committee recommends to the Board the performance measures of the CEO and other executive, evaluates the actual performance and recommends to the Board how much incentive pay to award. In determining its recommendations of annual incentive payments, the Committee considers the CEO's evaluation of each executive's performance.

The process for establishing the executives' compensation was flawed in much the same manner as was the process for the BCFS Board compensation. The BCFS Board and executive management had significant input into the selection of the comparators a consultant used as benchmarks, which raises questions about the independence of the benchmarking process. In our view, appropriate comparators for BCFS would be public sector monopolies of similar size. Instead, the majority of the 92 comparators used in the 2009 executive benchmark study were large, private sector organizations in competitive markets. Approximately 90% of the 92 comparators were large corporations such as Coca Cola Bottling Company, Ford Motor Company of Canada, Nike Canada Limited and McDonald's Restaurants of Canada. Some public sector organizations were also included, such as BC Hydro, the Vancouver Airport Authority and the Vancouver Port Authority.

We note that for the CEO and Chief Financial Officer (CFO) benchmarks the consultant used regression analysis to adjust for the differences between BCFS' revenues and earnings and those of the comparators.

In conducting our own comparisons we found the compensation paid to the executive team members of BCFS in 2008/09 was significantly higher than executives of large public sector entities. We compared BCFS' executive compensation to that of four public sector entities that were ranked higher than BCFS on BC Business magazine's list of the top 100 BC private, public and Crown corporations in terms of revenue - BC Hydro, ICBC, BC Lottery and WorkSafe BC. They were ranked 6th, 8th, 13th and 19th respectively; BCFS was ranked 43rd. The BCFS CEO's total compensation, at approximately \$1,035,000, was more than double the average of the other four CEOs total compensation (approximately \$455,000). The average total compensation of the other 4 BCFS executive, at approximately \$516,000, was approximately 75% higher than the average total compensation of the executives other than CEOs for whom compensation figures were available (approximately \$293,000).

Bonuses

We also had concerns regarding some of the measures and targets used to determine the performance bonuses.

Some measures would be commonly considered to be a normal requirement of the positions such as providing leadership and ensuring effective relationships with stakeholders.

Some targets appear to have been set too low to be challenging, as they were quite substantially exceeded. For 2008/09 the executive did not receive the full potential incentive amounts as corporate financial performance was below target. However, for the portion of the incentive amount that was based on their individual goals, each of the five executives received 100% of the maximum performance bonuses they could earn based on their personal goals, even though some targets were not fully met.

To be meaningful, the performance measures selected for purposes of making bonus payments need to be tied to the objectives of the organization and its public service mandate. Targets for these performance measures should be set at a level that is not easily attained (stretch targets); otherwise the incentive payment becomes effectively part of the base compensation.

Appendix 2 provides a summary of some best practice principles for compensation of public sector management that can be used by Boards and shareholders to guide management compensation programs that link pay and performance.

Say-for-Pay

A good business practice being introduced in the private sector, commonly referred to as “say for pay”, provides shareholders the right to vote on whether or not to approve a company’s executive compensation program. Through such a mechanism, shareholders can encourage the use of controls on executive compensation, such as hard caps, and thereby help ensure the level of executive compensation remains reasonable. The Authority, as shareholder of BCFS, has not adopted such a practice.

Recommendation

- 9) **We recommend the province amend the legislation to give the Authority the right and responsibility to vote annually whether or not to approve the BCFS executive compensation program (possibly non-binding and possibly including hard caps on executive compensation). Legislation should require the use of public sector guidelines on compensation.**
-

4.4 The Authority – Size, Composition and Appointment Process

We consider the size, composition and appointment process of the Authority reasonable. For the first year of this governance model, 2003/04, *the Act* stated the Authority's nine members would be the Directors of the former BC Ferry Corporation when the *Act* came into force.

Since then, the *Act* requires that the sitting members of the Authority are to fill vacancies as they arise. The *Act* also defines the ongoing composition of the nine members. Four are to be appointed from slates of nominees put forward by each of four regions (appointment areas created by the province, comprising 14 coastal regional districts). One is to be appointed from among nominees put forward by the union representing the BCFS employees. Two are to be appointed by the Lieutenant Governor in Council, and the standing Authority members are to appoint two others.

The *Act* requires that collectively the Authority members possess all the skills and experience identified in a Skills and Experience Profile established by the Authority and set out in the Authority's by-laws.

The Authority has no employees and any expenses incurred in performing its obligations are paid for by BCFS.

The primary role of the Authority as defined in the *Act* is to appoint the BCFS Board Directors. In light of concerns identified about the Authority having appointed themselves as the ongoing BCFS Board members, and their having permitted the identified flaws in the compensation-setting process, the nominating process needs strengthening to help ensure that quality candidates are appointed to the Authority.

Recommendation

- ¹⁰⁾ We recommend the union and the groups of regional districts who nominate slates of individuals from which the Authority can appoint replacement Authority members re-examine the process by which they select candidates for nomination, in light of the concerns raised in this report.**

4.5 The Authority – Compensation

The *Act* states that Authority members "are to be paid at the same rate as BCFS directors for the same service if they are not receiving remuneration already from BCFS". Therefore, provided that the same position is held in the Authority and BCFS, a Director receives a single fee for serving on both.

If, as recommended, the Authority becomes separate from the BCFS Board, the question will arise whether Authority members' remuneration should be the same as that of BCFS Directors. If our recommendation that the Authority determine the BCFS Board's remuneration is accepted, it would be inappropriate that Authority remuneration remain tied to that of the BCFS Board. The Authority members' remuneration should likely be lower because the nature and purpose of their responsibilities would be substantially less onerous than those of BCFS Directors. Reasonable benchmarks for compensation of the Authority would be public sector Authorities or Boards.

Recommendations

11) **We recommend the province amend the legislation to:**

- **remunerate Authority members consistently with reasonably comparable public sector Authorities and Boards, and**
- **ensure their remuneration is public information.**

4.6 The BC Ferry Commission

The size, composition and compensation of the BC Ferry Commission are reasonable for the current responsibilities the Commission has been fulfilling. The Commission consists of a Commissioner and a Deputy Commissioner. They are statutory officers appointed by the province for terms of six to eight years. The current Commissioner was appointed for a seven-year term that will expire in June 2010. The Deputy Commissioner was appointed in June 2008 for a six-year term. Their appointments can be renewed. The Commissioner's and Deputy's responsibilities are not full-time. The Commissioner has also been appointed as the TransLink Commissioner. The per-diem compensation of the BC Ferry Commission for 2008/09 was approximately \$59,000 for the Commissioner and \$39,300 for the Deputy.

They were also reimbursed a total of approximately \$8,500 for expenses such as travel and office expenses. The Commission employs no staff; it engages consultants as required to assist with its duties. We recognize that the broadened role of the Commission contemplated in section 1.0 above would result in the Commission requiring additional resources. However, there may also be economies if our recommendation to have one Transportation Commission is accepted.

Conflict of Interest

The Deputy Commissioner is a brother of a BCFS Board Director. We have been informed that both brothers were open about their relationship when the Deputy was being considered for the appointment, and the provincial Board Resourcing and Development Office approved the appointment of the Deputy. We found no evidence of any actual bias in the regulation of BCFS by the Commission resulting from the relationship.

However, we have received a legal opinion that though the relationship does not offend the conflict of interest provisions in the Act applicable to the Deputy, the relationship might be perceived by the public as being a conflict of interest and could result in damage to the credibility of the Commission.

We have raised this issue with the Commissioner.

5.0 BCFS' Operational Effectiveness

We reviewed BCFS' operating costs and service delivery model, including BCFS' actions to increase productivity and quality customer service, and its efforts to reduce costs using alternative ferry service providers, to ensure their ability to support the intended objectives.

Overall, we found the operations of BCFS to be reasonably well run within its legislated and contractual context. Aside from compensation issues discussed in section 4, appropriate financial and management controls and processes are established including planning, budgeting, monitoring, reporting, internal controls, a capital asset management framework, procurement policies, and an active internal audit function.

The company demonstrated that cost containment strategies, revenue generating efforts and customer service quality systems are in place. To improve operational effectiveness, changes may be needed in regards to the contracted service levels and the statutory requirement for seeking alternative service providers.

5.1 Operating Costs and Financial Management

The procedures we used for assessing BCFS' financial and operational processes and controls consisted primarily of interviews and review of documents to assess several key components of BCFS' financial and operational management systems. Based on this limited review, we conclude that BCFS generally uses sound financial and operational processes and controls and that costs are effectively managed.

Planning,
Monitoring and
Reporting
Activities

We reviewed the BCFS planning, budgeting, monitoring and reporting processes and were satisfied that these financial management processes support BCFS' efforts to contain costs. BCFS' cyclical planning and reporting process includes clear accountabilities, ongoing monitoring and reviews, and reporting to executive management and the Board of Directors.

The company uses a modified zero-based budgeting process to plan financial performance, and analysis of monthly variance reports helps ensure the budgets are adhered to and corrective action is taken as needed.

Cost
Containment

In addition to the general financial control processes as noted above, the company has a cost reduction plan and has implemented multiple strategies for containing and reducing operating costs.

The largest of BCFS' overall costs are labour, fuel, and capital costs (including amortization and debt servicing). Practical constraints limit BCFS' ability to control these major cost drivers. The majority of the BCFS workforce is unionized, so labour costs are largely set through the collective bargaining process. Fuel is purchased by BCFS in bulk at world market prices. Interest rates depend on BCFS' credit rating, and amortization is based on generally accepted accounting principles.

Regarding other costs, BCFS has demonstrated that a number of cost containment strategies have been implemented. We did not review the status and results of each strategy, but we observed that BCFS has an appropriate process for developing such strategies. Examples of their cost containment strategies include:

- a systematic fuel cost hedging program to smooth fuel purchase pricing;
- a fuel reduction strategy to reduce fuel consumption of its vessels and vehicles;
- elimination in late 2008 of over 70 management and administration positions and deferral of filling vacant positions; and
- introduction of the Experience Card to replace more expensive paper ticketing system.

Operations
Expenses as % of
Revenues

Figure 5.1a, presents the trend of BCFS' operations and maintenance expenses as a percentage of their revenue excluding capital contributions and interest income. Since 2003 operations and maintenance expenses have hovered between 64% and 70% of total revenue. This is indicative that BCFS' cost containment strategies are effective, particularly given the escalating labour and fuel costs in recent years. It also suggests that revenues have been increasing at approximately the same rate as costs. From our analysis, we noted that operations and maintenance expenses as a percentage of tariffs and net retail revenues has hovered around 93% since 2003. Therefore, BCFS is paying operational and maintenance expenses through tariff revenue while government support is required primarily for capital costs (interest and amortization).

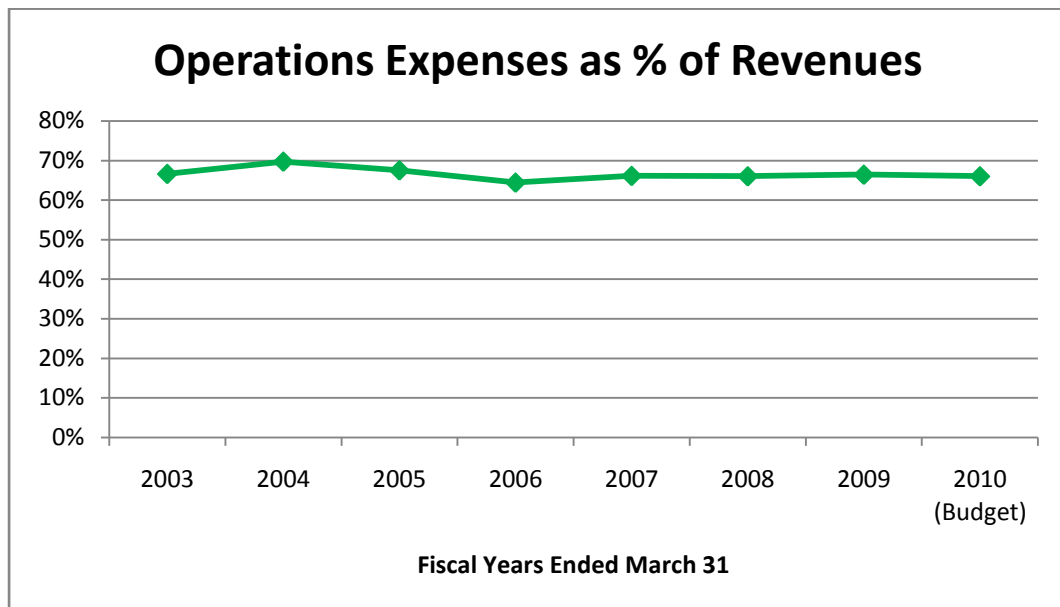


Figure 5.1a

Operating expenses vs. ridership and inflation

As shown in figure 5.1b, despite passenger volumes remaining stable through 2008 and dropping in 2009, operations and maintenance expenses have increased steadily since 2006 at a rate much in excess of the Vancouver Consumer Price Index (CPI). The increase can be attributed mainly to labour contract increases and higher fuel costs. BCFS' fuel costs represent a far higher component of its overall costs than the fuel cost component in CPI.

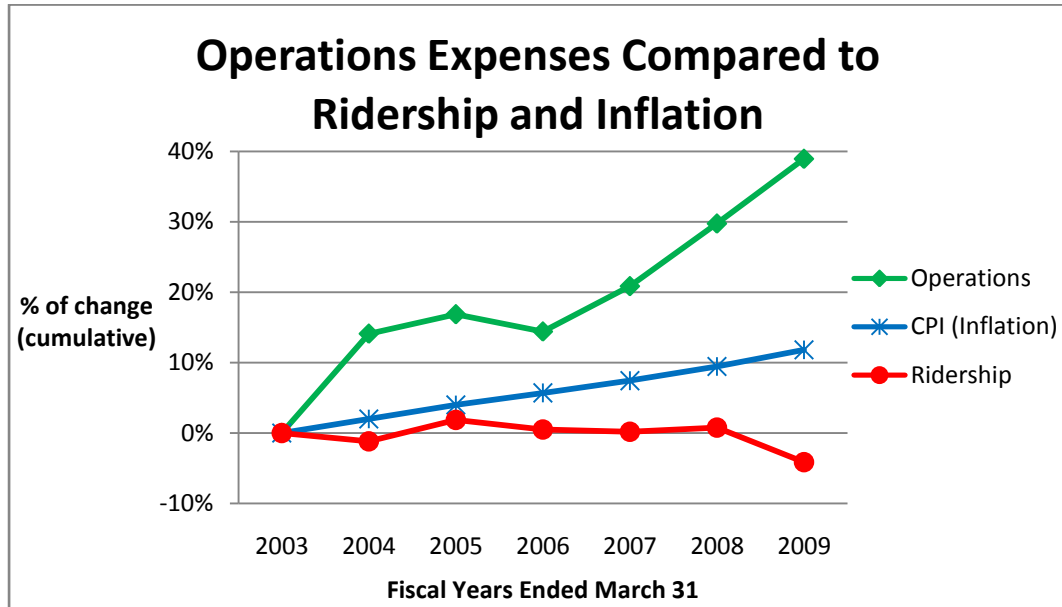


Figure 5.1b

Administration Expenses as % of Revenues

Figure 5.1c below presents BCFS' administration expenses as a percentage of total revenue. The graph reveals that a sharp drop in administration costs followed the restructuring in 2003. Since then, BCFS has held their administration costs at a reasonable level as total revenues are increasing sufficiently to maintain this level. We note that TransLink's administration expenses as a percentage of revenues have been approximately 4% or less up to 2008 which was significantly lower than BCFS' 7% to 8%. We did not explore the reasons for the difference, but we note that it may imply BCFS has further opportunities to reduce their administration expenses.

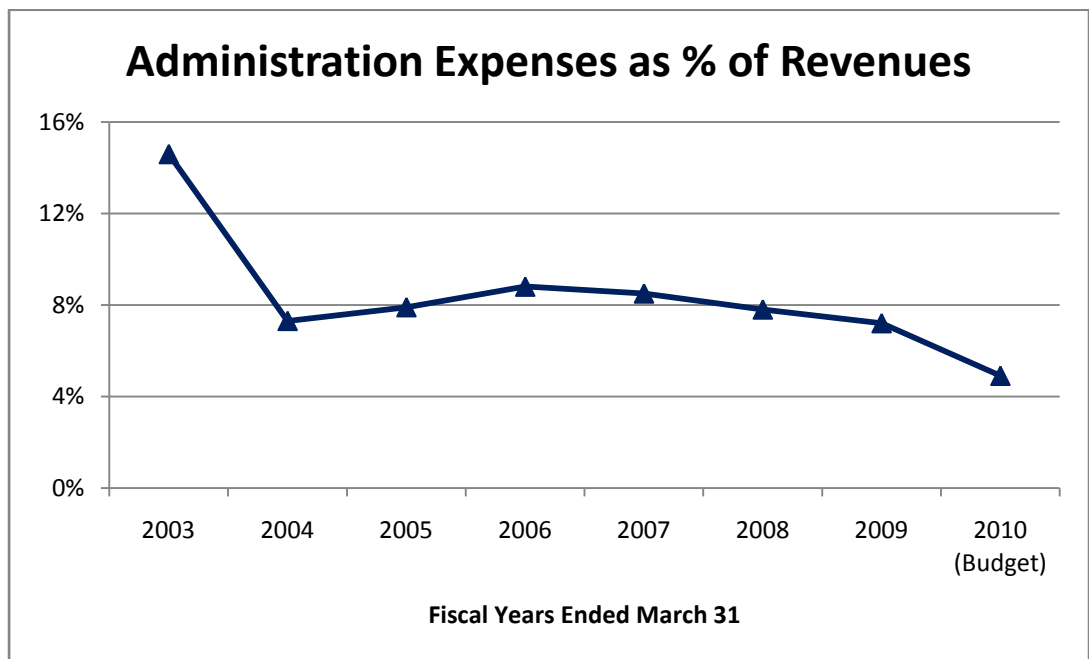


Figure 5.1c

Administration Expenses vs. Ridership and Inflation

As shown in figure 5.1d, even with inflation increasing steadily and ridership volumes remaining steady from 2003 through 2008 and dropping in 2009, administration costs have remained below 2003 levels and have decreased since 2006.

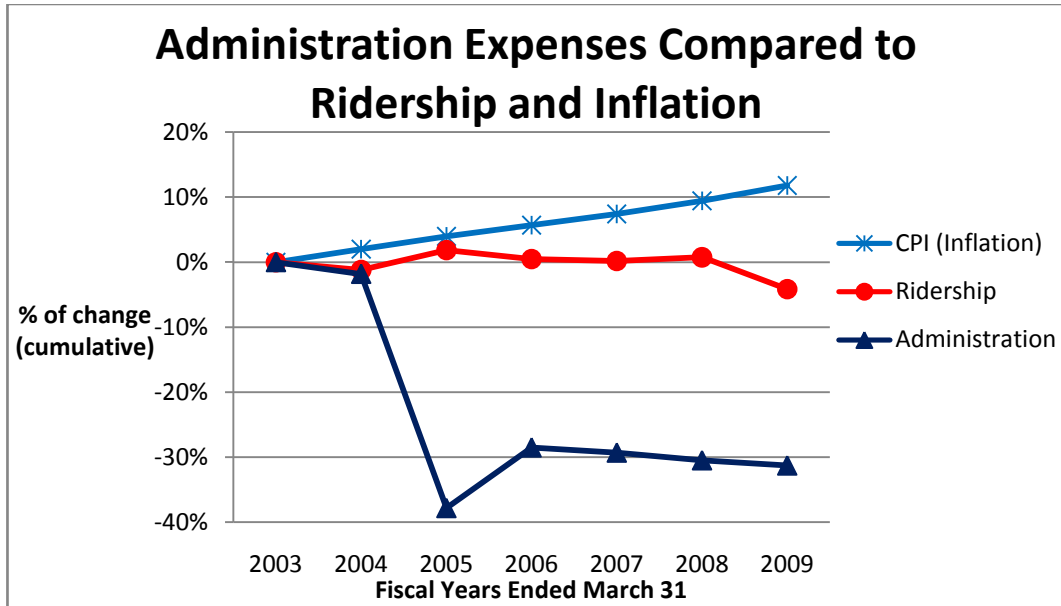


Figure 5.1d

For capital asset planning and reporting, BCFS has established a formal project management framework and guidelines that includes a five year rolling capital asset plan that is updated by management and approved by the Board of Directors annually; formal business cases for all capital projects; use of project management principles; clear assignment of accountabilities to project manager, project owner, and project sponsor; and monthly reporting and monitoring of all active projects. A management committee chaired by the CFO meets monthly to review reporting and any capital related requests.

BCFS has successfully acquired independent financing and has dealt with one of the major challenges it inherited when it was established – a seriously aging fleet. It has replaced most of its larger ships and has well-defined plans to replace and re-fit other vessels.

As a result, debt, interest expense and amortization have increased substantially in recent years. Another upward pressure on BCFS interest expense is the fact that their borrowing rate runs approximately 1.25% higher than the province's rate. This equates to nearly \$14 million per year on the \$1.1 billion of senior bonds outstanding in 2009. (This cost was anticipated when BCFS was created in 2003.)

BCFS' financial projections, which are based on plausible assumptions, indicate the company will be able to finance its capital acquisition plan for the next five years from expected cash flows based on their estimates of growth in fare rate caps and traffic volumes. Less clear is how they will finance the larger capital outlays that are forecast six years out and beyond.

Having observed that BCFS capital planning looks only five years ahead (though they also do some internal 15-year planning), we recommended to BCFS that their formal capital planning be more long-term, along the lines of the ten year capital planning window used by TransLink, the province's master transportation plans and the province's capital plans for the inland ferries system.

The following two graphs provide views of the changes in BCFS' debt service coverage ratio and interest expense in the past few years.

Debt Service Coverage Ratio

Figure 5.1e shows the debt service coverage ratio has been relatively strong since 2003 despite the sharply increased debt load related to fleet expansion (long-term debt grew from zero in 2003 to \$1.356 billion in 2009), allowing BCFS to meet its debt servicing obligations, fund operations, and meet future capital needs.

A bond indenture requires that BCFS' debt service coverage ratio remain above 1.5. BCFS advises us that using the formula in their Master Trust Indenture, the debt service coverage ratios for 2005 to 2009 were 4.62, 4.76, 5.07, 3.31 and 2.52. The ratios in Figure 5.1e are somewhat different, having been calculated using a different formula as explained below the Figure,

With the additional funded debt required for the major vessel replacement program, the debt service coverage ratio has declined as shown in Figure 5.1e, but has remained above the required minimum. Standard & Poor's have projected it will decrease to 2.3 in 2010 and then rise again.

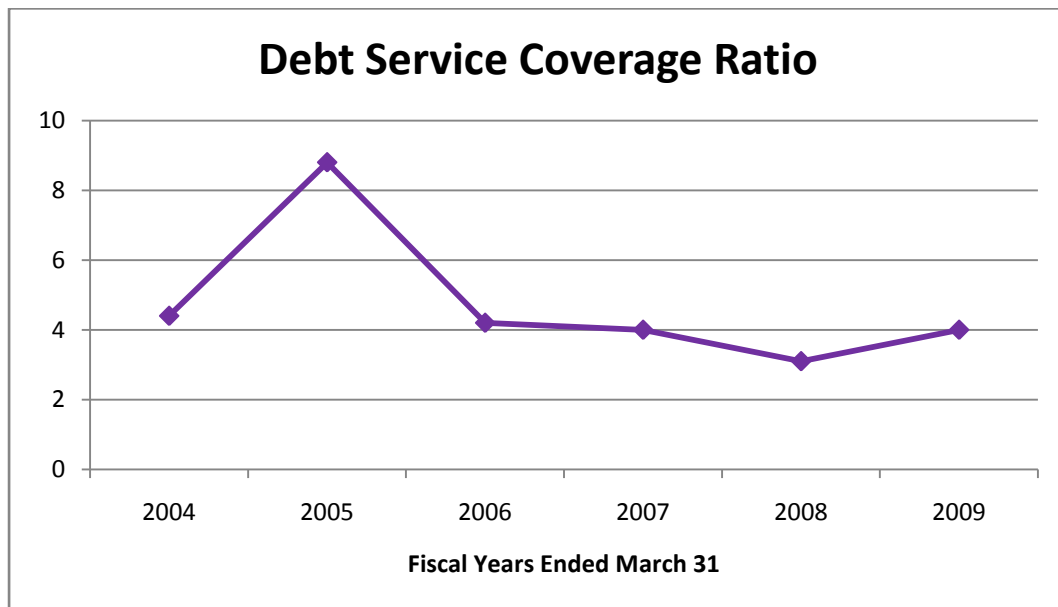


Figure 5.1e – Calculated as earnings before debt interest and amortization divided by (debt interest and principal payments)

Interest Expense
as % of Revenue

Figure 5.1f shows that interest expense as a percentage of revenue was fairly stable at approximately 4% from 2004 to 2007 and has been rising steadily since then to a budgeted high of 9.1% in 2010. The sharp increase was due to the extensive vessel replacement program which has added \$850 million of funded debt, all at fixed rates, since 2005. As ridership remained fairly consistent over this period, with a drop in 2009, debt servicing cost per passenger has risen.

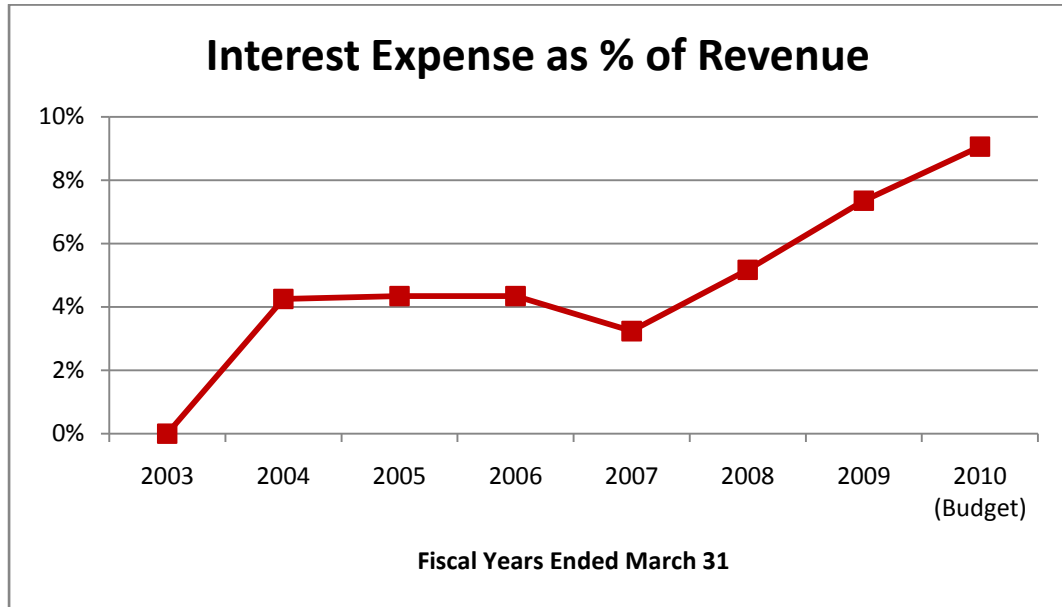


Figure 5.1f

Risk
Management
and other
Controls

The company has a formal risk management system in place for identifying, mitigating and monitoring risks. Risk registers with mitigation strategies are routinely reviewed and reported up to the Board level.

We suggested to BCFS two ways to improve their existing good risk management processes. They could develop a formal risk management plan including allocations of specific responsibilities, milestones and timelines. They could also expand their risk identification process to include identifying the risks to achievement of their corporate objectives, and feeding the results into the company's strategic planning.

We also identified the following processes that support cost containment and effective management.

BCFS has appropriate procurement policies in place. The supply chain policies and procedures are generally aligned with the spirit and intent of the province's procurement policies, which are recognized as good practice.

BCFS has an active, independent internal audit function. It reports to, and has its annual audit plan approved by, the Audit and Finance Committee of the Board of Directors.

Internal control system descriptions have been comprehensively documented by BCFS for their major business processes. These are audited on a cyclical basis by BCFS' internal audit department.

Major operational projects and all capital projects are supported by the use of business cases that document key decision-making elements such as budget, schedule, options, cost/benefit or net present value and risks.

The methodology for allocation of costs over the routes was approved by the Commission and by the province in 2003. The method allocates various costs based on reasonably related variables such as passenger volumes, vehicle volumes, and vessel sailings.

5.2 Service Delivery

BCFS' service delivery model is essentially set in the *Act* and the Contract. Minimum service levels are specified in the Contract, including the mandatory core routes, frequency of sailings, and hours of operation.

Fares are regulated by the Commission. The Commission also monitors BCFS' adherence to the contracted service levels and encourages productivity by setting a productivity factor when establishing the fare price caps.

5.2.1 Productivity

Capacity Utilization

On average, the ferries run only half full. In 2009, capacity utilization on all routes averaged 52% and specific routes were as low as 25% and as high as 75%. Capacity utilization by route group was as follows: Major routes – 64%; Langdale/Horseshoe Bay – 56%; Minor routes – 42%; and Northern routes – 66%. While BCFS does monitor capacity and has identified opportunities for service adjustments, there has not been a comprehensive re-evaluation of the service model aspects of how frequently and at what times each community is served and whether there are other communities that should be served.

Under the terms of the Contract, BCFS is obliged to continue to provide no less than the contracted service levels to the currently-served communities regardless of how low capacity utilization might fall on some routes.

As part of the BC Ferries service planning framework, the province could amend the *Act* to require that BCFS conduct regular evaluations of the service model, with public input. This would provide periodic opportunities for BCFS, with input from the public and the community-based ferry advisory committees, to identify innovations that may provide better service value for the available resources. The objective of the evaluations should be to optimize the balance among the taxpayers' desire to minimize taxes and fares while maintaining acceptable service levels, and the need for BCFS operations and the ferry system to be sustainable over the long term.

These evaluations should be reviewed and commented on by the Ferry Commission. The comment could include observations on alignment with the governance model objectives and the viability of the options presented from all stakeholders' viewpoints. The Commission's comments, along with public input received, could be provided to the Authority, the ministry and BCFS.

This independent assessment and information could then be used by the ministry in reviewing mandatory service levels and negotiating with BCFS in order to ensure value from the contract is maximized to the benefit of the communities, fare payers and taxpayers for the service fees paid.

Recommendations

- 12) **We recommend that as part of the enhanced service planning framework the province amend the legislation to require that:**
 - **BCFS periodically re-evaluate, with public consultation, route service levels with a view to optimizing use of available resources while maintaining acceptable service levels in order to balance taxpayers and fare-payers interests with the need for long-term sustainability of BCFS operations and the ferry system.**

- **The Ferry Commission periodically conduct independent evaluations and comment on the service plans. As part of these evaluations, the Commission should invite public input. The results of these evaluations would be provided to the Authority, the ministry, and BCFS.**

13) **We recommend the province consider this information in re-evaluating the service levels in the contract with a view to minimizing the costs and maximizing the benefits of the service fees paid.**

Revenue
Generation

Our review of BCFS' productivity found that the company has multiple revenue generating strategies in place, from late night sailings to serving the drop-trailer market. The strategies are supported by business cases and marketing plans, and are overseen by the Board of Directors. BCFS assesses the strategies' success by measuring results against the business cases' targets or by customer satisfaction surveys. BCFS' revenue generation strategies are also identified on the public websites of BCFS and of the Commission.

Some of the revenue generating initiatives also have customer service improvement and cost containment benefits. An example is the outsourcing of the Tsawwassen Quay Market.

5.2.2 Customer Service

BCFS has maintained its customer satisfaction survey scores at a consistently high level over the past five years. Since 2003 survey results showed that 82-89% of passengers were satisfied or very satisfied with their overall experience of BCFS.

We reviewed BCFS' actions to maintain and increase the quality of its customer service. BCFS informed us that customer input as reported in customer surveys is a driver for new initiatives.

We enquired about specific customer service improvement initiatives undertaken by BCFS. BCFS reported having planned a number of customer service initiatives (for example, implementing Smart Media) and implemented many such initiatives over the last two years. BCFS also stated that customer satisfaction surveys have garnered positive comments on such initiatives as the reservation system, highway signage about how full ferries are, and TV monitors in on-board passenger seating areas.

5.2.3 Alternative Service Providers

The *Act* requires that BCFS seek alternative ferry service providers in an effort to reduce the costs of providing those services. The Commission is provided with BCFS' alternative service provider plan to assess for compliance with the *Act*. BCFS has made some efforts to seek alternative service providers, and they informed us that doing so has been costly and time-consuming. As well, there are structural impediments in this requirement such as the need for BCFS to support their own competition as well as maintaining capacity to step in should an alternative service provider fail for any reason. Hence, their efforts have not been effective. No alternative ferry service providers have been added since early 2003. Given BCFS' monopoly on its services, we question the practicality of requiring BCFS to seek others who could provide ferry services on BCFS' routes at lower cost. The challenges involved are likely to persist.

Suggestion

We suggest the province consider whether to amend the *Act* in respect of the provision requiring that BCFS seek alternative service providers to provide ferry services at lower cost, on the basis that it may not be a practical expectation.

In case the province decides to retain this statutory requirement, we have made a recommendation in section 3.3 that the Commission's role be strengthened in regards to BCFS' efforts to find alternative service providers.

6.0 BC Ferries Alignment with the Governance Framework

As noted in section 1.0 above, A Framework for Transportation Governance, one of the objectives of this review was to identify and consider options available to the province that, while respecting the organizations' independence, ensure that BC Ferries, TransLink and other models for independent, regulated services that the province may create in future are effectively structured to:

1. protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members;
2. protect clearly mandated customer service levels;
3. minimize cost and maximize benefits to BC taxpayers of provincially funded grants; and
4. improve transparency and public accountability for decisions and performance levels.

The current governance model for BC Ferries can be modified to more clearly fulfill those four principles while respecting the independence of BCFS. Our preceding recommendations and which of the four listed principles they support are presented in the table that follows subsection 6.1 below.

6.1 Additional Option for Governance of BC Ferries

Given the province has retained ownership of the ferry terminals and is leasing them to BCFS under a long-term lease arrangement, the province could consider implementing a model similar to that of the Vancouver International Airport Authority. Under this model, an Authority would control the ferry terminals, deriving revenue from the ferry operators who use the terminals. We have not explored the implications of this option, but we identify this option here in accordance with the terms of reference for this review which stated that the review might identify areas where further examination is warranted.

BC Ferries – Summary of Recommendations

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency & Accountability
<p>About the Authority, we recommend the province amend the legislation to:</p> <ul style="list-style-type: none"> require that Authority members be independent from BCFS and its Board members; require that the Authority use competency-based criteria for the selection of members of the BCFS Board; require that the BCFS CEO and other executive not be members of the Authority or voting members of the BCFS Board; expand the Authority’s mandate to include shareholder functions such as providing broad strategic direction to the BCFS Board; overseeing the BCFS Board; establishing the remuneration and terms of service of the BCFS Board members; and reviewing and approving or rejecting long-term, strategic and direction setting proposals from the BCFS Board and management; give the Authority the right and responsibility to vote annually whether or not to approve the BCFS executive compensation program (possibly non-binding and possibly including hard caps on executive compensation). Legislation should require the use of public sector guidelines on compensation; and remunerate Authority members consistently with reasonably comparable public sector Authorities and Boards, and ensure their remuneration is public information. 	 ✓ ✓ ✓ ✓	 ✓ 	 ✓ ✓ ✓ ✓	 ✓ ✓ ✓ ✓

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency & Accountability
<p>About the Authority, we recommend the union and the groups of regional districts who nominate slates of individuals from which the Authority can appoint replacement Authority members re-examine the process by which they select candidates for nomination, in light of the concerns raised in this report.</p>	✓		✓	✓
<p>About the Commission, we recommend the province consider amending the legislation to change the Commission’s required responsibilities to include:</p> <ul style="list-style-type: none"> • a seventh guiding principle, protecting the interests of ratepayers and customers; • protecting consumer interests and ensuring effective management of customers’ complaints; • regulating competitive services (such as BCFS’ ‘drop trailer’ service) separately from its regulation of the transportation of vehicles and passengers; • regulating reservation fees, considering those fees to be effectively part of the fares for transportation of passengers and vehicles; • assessing and commenting publicly on: <ul style="list-style-type: none"> ➤ BCFS’ 10 to 15 year strategic and capital plans and their implications for future services, fares and provincial/federal service fees; ➤ The reasonableness of the levels and nature of BCFS’ operating and capital costs; ➤ BCFS’ efforts to control costs and maximize revenues from sources other than fares; 	✓	✓	✓	✓

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency & Accountability
<ul style="list-style-type: none"> ➤ The fairness of BCFS' allocations of costs among its routes and its management of fuel surcharges and rebates; ➤ BCFS' plans to seek Alternative Service Providers (ASPs) and their processes for choosing the routes for which to solicit ASPs, for soliciting ASPs , and for selecting among ASP proposals received; and ➤ BCFS' service levels and standards with consideration of the need for balance among capacity, cost and service levels. • applying increased verification procedures to the information provided the Commission by BCFS to ensure its validity (particularly financial and service level reports); and • issuing an annual public opinion on the performance of the BC Ferry Authority in carrying out their legislated responsibilities and accountabilities (i.e. Board appointments, overseeing the Board, approval of compensation plans, etc). 	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>	<p></p> <p>✓</p> <p>✓</p> <p>✓</p> <p></p>	<p>✓</p> <p></p> <p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>
<p>About transparency, we recommend the province:</p> <ul style="list-style-type: none"> • consider making BCFS and the BC Ferry Authority, including the compensation they pay, subject to the <i>Freedom of Information and Protection of Privacy Act</i>; • require BC Ferries to provide the Commission their methodology for allocating costs among its routes for price cap calculation purposes by major cost category along with the resulting cost allocations by route. The Commission should make this information public. BC Ferries could decide to proactively release this information as well; and 	<p>✓</p> <p>✓</p>	<p></p> <p></p>	<p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p>

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency & Accountability
<ul style="list-style-type: none"> consider amending the legislation to change the Commission's required responsibilities to include ensuring the public is kept aware they can provide the Commission their views and concerns about BCFS' operations and performance through such vehicles as public hearings or written submissions. 	✓	✓		✓
<p>About the intentions behind the model, we recommend the province review, clarify and update the legislation to reflect fully its current intentions and objectives for the coastal ferry system governance model.</p>				✓
<p>About service levels, we recommend that as part of the enhanced service planning framework the province amend the legislation to require that:</p> <ul style="list-style-type: none"> BCFS periodically re-evaluate, with public consultation, route service levels with a view to optimizing use of available resources while maintaining acceptable service levels in order to balance taxpayers and fare-payers interests with the need for long-term sustainability of BCFS operations and the ferry system. The Ferry Commission periodically conduct independent evaluations and comment on the service plans. As part of these evaluations, the Commission should invite public input. The results of these evaluations would be provided to the Authority, the ministry, and BCFS. <p>We recommend the province consider this information in re-evaluating the service levels in the contract with a view to minimizing the costs and maximizing the benefits of the service fees paid.</p>	✓	✓	✓	✓

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency & Accountability
<p>About the Act, we suggest the province consider whether to amend the <i>Act</i> in respect to the provision requiring that BCFS seek alternative service providers to provide ferry services at lower cost, on the basis that it may not be a practical expectation.</p>			✓	✓

7.0 TransLink – Overview

The South Coast British Columbia Transportation Authority (referred to as TransLink in this report) is Metro Vancouver's regional transportation authority, responsible for regional transit, cycling and commuting options as well as AirCare and Intelligent Transportation System programs. Created in 1999 and originally named the Greater Vancouver Transportation Authority, it delivers services through contractors as well as its subsidiaries including Coast Mountain Bus Company Ltd., British Columbia Rapid Transit Company Ltd. (SkyTrain) and West Coast Express Ltd.

By way of funding background, historically, BC Municipalities collect 40% of hospital capital costs through property taxes. Prior to the formation of TransLink, municipalities in the Greater Vancouver Regional District (GVRD) also collected hospital capital costs through property taxes.

When TransLink was created in 1999, it was agreed that the province would take over full responsibility for paying for hospital capital in the GVRD. The province's funding of hospital capital, in effect, created property tax room in the region to help pay for TransLink. Therefore, GVRD agreed to increase funding to TransLink through property taxes.

In comparing the combined health capital and transit portions of property tax, we found the percentage paid by property owners in Metro Vancouver for these elements generally comparable to municipalities elsewhere in BC. This comparison did not include other taxes such as the fuel tax.

Figure 7.0 below represents the transit percentage of property tax for major Canadian cities on an average single family home. Based on 2007 data supplied by TransLink, the transit portion of property tax and utility charges collected from Vancouver property owners is 3.1% or \$115. Most major Canadian cities contribute from 4% to as high as 11.1% to transit, this equates to an average amount between \$131 and \$446 on an average single family home.

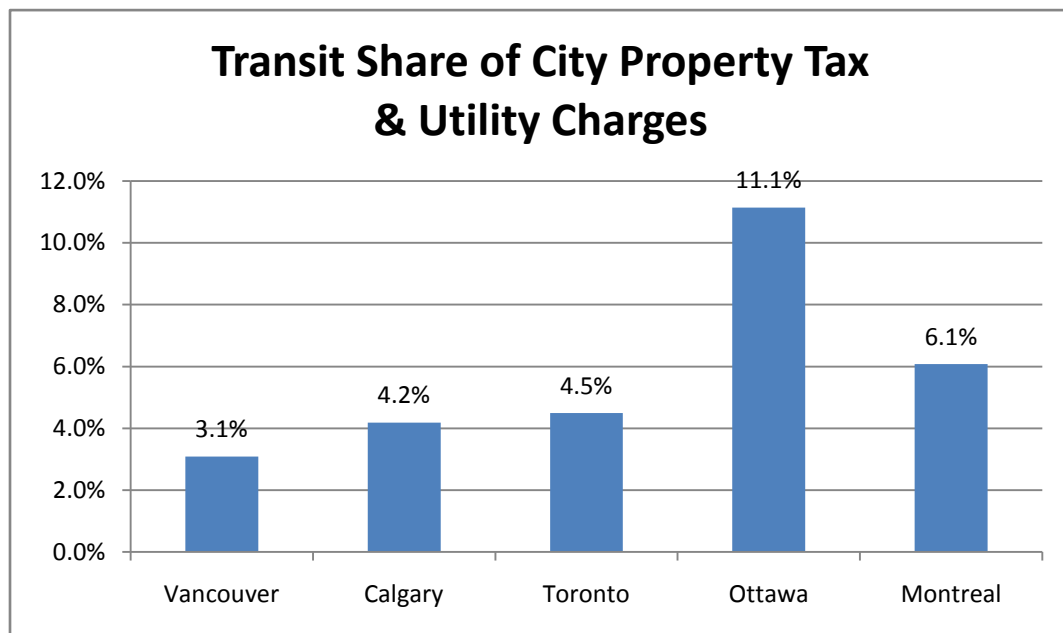


Figure 7.0

In 2007, following a governance review, the governing legislation, now named the *South Coast British Columbia Transportation Authority Act*, was revised and the operating entity was renamed the South Coast British Columbia Transportation Authority. The operating entity's purpose, as outlined in the legislation, is to provide a regional transportation system that is efficient and that supports regional growth, environmental objectives and economic development of its service region.

The key components of the TransLink governance structure are:

- The South Coast British Columbia Transportation Authority (TransLink) and its subsidiary operating companies;
- The TransLink Board of Directors;
- The Mayors' Council on Regional Transportation;
- The Regional Transportation Commission (the TransLink Commission); and
- *The South Coast British Columbia Transportation Authority Act.*

The Mayors' Council appoints the TransLink Commissioner and the TransLink Board of Directors, provides input into long-term transportation strategies and rolling 10-year plans, receives long-term strategies, rolling 10-year plans and reports from the TransLink Commission and approves or rejects changes to TransLink's rolling 10-year plans that expand key revenue sources. The Mayors' Council is currently comprised of the Metro Vancouver region's 21 mayors and one First Nations band chief. Members of the Mayors' Council are elected to office in their respective municipalities.

The TransLink Commission is TransLink's independent regulator. The TransLink Commission reviews and comments on TransLink's 10-year plans and reports annually to the Mayors' Council on TransLink's performance relative to its 10-year and operational plans.

The TransLink Commission also approves increases to short-term fares that exceed 2% per annum, the process for undertaking annual customer satisfaction surveys, the complaints resolution process and subsequent amendments to either of the processes and the sale of major assets.

TransLink has four active wholly-owned subsidiaries, a captive insurance company that is jointly owned by TransLink and BC Transit, and contracts with independent operators for the delivery of transit, road services and travel alternative programs to manage the demand on the transportation system. In 2008 TransLink and its subsidiaries employed a workforce of over 6,100 employees.

Transit services are delivered primarily through three of the subsidiaries using a fleet of over 1,400 buses plus passenger ferries, light rail cars and commuter rail trains. In fiscal 2008, TransLink had approximately 180 million passengers.

TransLink funds its operations, capital expenditures and debt service payments with revenues from transit operations, taxation revenues, capital contributions from senior levels of government and issuance of long term debt. TransLink also shares responsibility for the Major Road Network and regional cycling with municipalities in Metro Vancouver.

8.0 Governance – TransLink

We reviewed the following aspects of the TransLink governance model to ensure their ability to support the intended objectives:

- The division of responsibility between the province, TransLink, the Mayors' Council and the Commission.
- The regulatory environment, including responsibilities, authorities, and powers of the Commission.

Overall, our review of the division of responsibilities between the province and the respective entities, the regulatory environment, and the powers of the TransLink Commission identified that accountabilities and some responsibilities remain unclear. This governance structure had only been in place for about a year and a half at the time of our review and it was apparent the Mayors' Council has struggled with their limited role as Mayors' Council versus their previous role as the Board Directors of TransLink. This lack of clarity compounded by the conflicting interests amongst parties has contributed to the limited progress towards resolution of the structural deficit that TransLink now faces. Critical cost containment and revenue stream issues have been left unaddressed. Therefore, clarification and reinforcement of roles, responsibilities and accountabilities and improved strategic alignment and communication amongst respective government parties is required.

8.1 The Intended Objectives

The intended objectives of the model are not sufficiently clear about governance roles and responsibilities. Changes are needed to better align the TransLink model with the governance framework described in section 1.0.

TransLink's purpose, as outlined in the *Act*, is to provide a regional transportation system that is efficient and that supports regional growth, environmental objectives and economic development of its service region.

The key intentions of the revised legislation were to improve the governance, support TransLink in its purpose, and as discussed later in the report, improve planning, funding capabilities, financial sustainability, and accountability and transparency.

The terms of reference for our review indicate that the Province considers other intentions important. One of the review's objectives indicates that TransLink and other independent, regulated, publicly created organizations should be effectively structured to:

1. protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members;
2. protect clearly mandated customer service levels;
3. minimize costs and maximize benefits to BC taxpayers of provincially funded grants; and
4. improve transparency and public accountability for decisions and performance levels.

Throughout our review, we have assumed that these four principles are among the province's present intended objectives for the TransLink governance model.

These four principles should, also, be considered to guide the effectiveness of future applications of independent, regulated, publicly created authorities.

We observed multiple areas where progress is needed with regard to these four principles. Throughout this report, we will discuss options and make recommendations to support these four principles, particularly balancing the interests of ratepayers and taxpayers, while achieving user service needs.

Planning

The current planning structure for TransLink is challenged as a result of ineffective communication between TransLink, the Mayors' Council, the TransLink Board of Directors and the province, and the short time frames allotted to conduct planning and satisfy the complex statutory funding requirements.

The 2007 TransLink governance review identified the need for a longer term, financially viable, integrated planning approach. TransLink plans now consist of an annual base plan, a 10-year strategic plan, and a 30 year outlook/vision. Under the *Act*, all 10-year plans must have all of the required funding clearly identified.

The plans are region-wide and are intended to support regional economic development and the regional growth strategies of the GVRD.

The *Act* is prescriptive, particularly regarding planning timelines. The prescribed timelines have put time pressure on all parties and have not allowed for adequate consultation with all stakeholders. For example, the legislated requirement to develop a fully defined, fully funded 10-year plan within 8 months does not allow sufficient time for feedback to be gathered, considered and incorporated and to ensure that the long term plan is viable and has the support of the key partners and stakeholders.

The further a planning model forecasts into the future, the less accurate the projections and underlying assumptions are likely to be, due to a range of factors including changes in the economy and difficulty of predicting economic patterns and user behaviors in the future. The requirement of a fully funded 10-year plan is therefore not ideal.

If the plans were to include a shorter fully funded period of perhaps 3 to 5 years and a longer, 10 to 15 year outlook, consensus support could be easier to obtain.

At present, there is no requirement in legislation for integration of TransLink's, municipalities' and provincial transportation and community plans. We were advised that provincial input into TransLink's 10-year plan has been limited. The complex planning model, the communication and relationship challenges both within TransLink and between TransLink, the Mayors' Council and the province, and the need to integrate with 21 official community plans all combine to make it difficult to gain agreement, develop shared priorities and achieve long term financial sustainability for TransLink. A more integrated approach might, for example, provide TransLink an improved range of taxation and revenue tools, and that could enable TransLink to be more efficient, effective and sustainable for the long term.

One option for ensuring there is active and meaningful dialogue between the ministry and the Mayors' Council would be to have provincial representation at the Mayors' Council. This would facilitate ongoing communication and strategic alignment between the parties.

Should this recommendation be adopted, the province could consider changing the name of the Mayors' Council to "The Transit Authority". From this point on, this report will refer to the Mayors' Council as the Mayors' Council/Transit Authority. The provincial representation should be in the minority, both in terms of the number of people and any voting influence.

Recommendations

¹⁴⁾ We recommend the province:

- **provide for greater flexibility and consultation within the planning framework by revising the legislation and expanding the timelines to allow for dialogue among stakeholders;**
 - **shorten the timeframe covered by the plan. For example; a shorter fully funded 3 to 5 year plan with a 10 to 15 year outlook may be more appropriate; and**
 - **consider amending the legislation to allow for provincial representation, to a maximum of 20%, at the shareholder group (Mayors' Council/Transit Authority) in order to facilitate active involvement and strategic alignment among the government bodies. The revised group could be re-named "the Transit Authority" to reflect its broader membership.**
-

8.2 Structural Deficit

The most significant issue now facing TransLink is its structural deficit. Without supplemental funding through increases on existing taxes or the introduction of new taxes or other revenue sources, current revenue streams/reserves will fall approximately \$130 million short of operating expenses and carrying costs.

It is clear that in 2004 the previous Board (which was comprised mainly of the elected mayors at that time) was aware of projected deficits. In 2006 it was identified that deficits would occur from 2009 onwards. With that knowledge, the previous Board failed to institute adequate cost containment measures and continued the unfunded expansion in 2007 by acquiring additional buses and SkyTrain cars. Rather, TransLink has pursued a program of expansion in order to encourage increases in ridership.

As well, the province highlighted the impending structural deficit in its 2007 TransLink governance review.

Current funding levels are insufficient to maintain or enhance current and future operations. If there is no increase in supplemental funding for 2010 and beyond, TransLink advise they will have to apply “Drastic Cuts¹” to citizens’ services to remedy this structural deficit.

Supplemental plans for funding increases between \$130 million and \$275 million have been submitted to the Mayors’ Council by the TransLink Board of Directors. A supplemental plan (“On Track – Expansion program”) identified \$450 million of increased spending but did not identify all of the needed funding. The TransLink Commissioner advised that this was not a legitimate supplement to be accepted or rejected by the Mayors’ Council.

Further information on TransLink’s supplemental financial plans may be found on TransLink’s website at: www.TransLink.ca.

A further explanation of the costs and funding of the transportation system follows in section 10.

The structural deficit is important context for understanding the following discussion on the challenges of the current governance model.

¹ <http://www.translink.ca/en/Get-Involved/featured-Be-Part-of-the-Plan/Be-Part-of-the-Plan-Choices/Choice-Drastic-Cuts.aspx>

8.3 The Mayors' Council on Regional Transportation

There is uncertainty over the Mayors' Council role and its current responsibilities. Recognizing that the current governance model for TransLink was only implemented about a year and a half ago, and while we appreciate this was a transition period for the new roles, we found significant operational issues that have gone unaddressed in the years preceding the governance change. Inaction by TransLink and the Mayors' Council to maintain a balance between expenses and revenues has brought TransLink to a point at which substantial operating deficits in 2010 and beyond will be difficult to avoid (a structural deficit).

The Mayors' Council has experienced challenges with its more limited role as the Mayors' Council and determining how it can best add value to TransLink's operations.

Following the 2007 governance report, the *Act* was changed to create the Mayors' Council and while it assigned some responsibilities to them. We noted that there is no dedicated section in the legislation which clearly sets out all of the current Mayors' Council roles and responsibilities. It is unclear to the Mayors' Council what level of consultation and information it is entitled to under the *Act*.

The new TransLink Board of Directors also expressed uncertainty as to how and the degree they were to engage with the Mayors' Council during the recent 10 year planning process.

As a result, accountability is uncertain. For example, it is unclear whether the Mayors' Council role is solely to receive plans or if it has the power to hold TransLink accountable to its established goals, objectives and specific performance measures.

To ensure clear accountability and responsibilities the Mayors' Council/Transit Authority should fulfill the role of the shareholder as depicted in our governance framework diagram 1A and as explained in Appendix 1. The shareholder role includes overseeing the Board at a high level, providing broad policy direction, appointing Directors and establishing their remuneration. In order to have the proper level of accountability and ownership for TransLink's performance the Mayors' Council/Transit Authority needs to be able to do more than the current process of receiving the plan. It needs to have clear responsibility for the Board's strategic planning actions.

Given the size of the existing Mayors' Council/Transit Authority, a future consideration could be to reduce the size of the Council closer to the private sector best practice Board size of 9 to 11 members. This could assist with efficient planning and decision making. In reducing the size of the Mayors' Council/Transit Authority, consideration would still need to be given to maintaining taxation with representation.

Recommendations

- 15) **We recommend the province consider amending the legislation to clarify the roles and responsibilities of the Mayors' Council/Transit Authority. The roles and responsibilities to be clarified include:**
- **establishing clearly that the Board is accountable to the Mayors' Council/Transit Authority, including removal of members from the Board;**
 - **overall responsibility for the performance of the Board;**
 - **providing broad strategic direction to the Board;**
 - **providing oversight over the Board;**
 - **establishing the remuneration of the Board members;**
 - **establishing the terms of service of the members of the Board;**
 - **reviewing and approving or rejecting long-term, strategic and direction setting proposals from the Board and management; and**
 - **the Mayors' Council/Transit Authority needs to act as a shareholder and not as management.**

8.4 The TransLink Board of Directors

2008 was a transitional year for the Board, with little progress being made in regard to some of TransLink's pending financial challenges. Board members have more recently made progress towards adopting a business-like approach by providing TransLink staff with clear direction in areas such as capital spending, customer focus, enhanced revenue and improved reporting with their most significant accomplishment being delivery of the 10-year plan to the Mayors' Council.

We also noted improvements in environmental initiatives and strong transparency and public consultation.

The TransLink Board must function in a challenging context and it will take strong communication between the Board, the Mayors' Council/Transit Authority and the province for TransLink to be successful. The lack of shared priorities and agreed objectives continues to exist amongst the mayors, the Board and the Province. This is most evident in the lack of action to resolve the pending structural deficit. Overall there needs to be more effective communication and negotiation among the parties.

Given the deficit that TransLink is facing in the coming years, more aggressive and proactive measures should be taken by the Board as soon as possible to create operational efficiencies, reduce costs and increase revenue to mitigate the impact of potential taxation increases required by TransLink.

8.5 The Ministry of Transportation and Infrastructure

The *Act* does not identify the ministry's role or responsibilities in the governance structure. Given the interdependence inherent in the governance framework, meaningful and constructive dialogue between the stakeholders is essential. There is a statutory requirement that TransLink consult with the ministry on long range plans and capital funding discussions.

Given the ministry's transportation mandate and interests, it is imperative that the ministry, the Mayors' Council and TransLink consult meaningfully and productively. Their consultations need to include such things as the Provincial Transit Plan and practical implications of specific 10-year plan funding issues such as the vehicle levy.

We were advised that opportunities exist to enhance relationships and strengthen the interplay of roles and responsibilities and communications among the stakeholders as a way of supporting the overall effectiveness of TransLink, including resolution of current issues, such as the funding deficit.

The province could enhance the governance structure by clarifying in the legislation, roles and responsibilities for the Mayors' Council/Transit Authority, the Board and the province.

As well, the province could consider the following four principles when reviewing the legislation and TransLink's responsibilities. TransLink and other independent, regulated, publicly created organizations should be effectively structured to:

- protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members;
- protect clearly mandated customer service levels;
- minimize costs and maximize benefits to BC taxpayers of provincially funded grants; and
- improve transparency and public accountability for decisions and performance levels.

Building these four objectives into the appropriate governance roles will facilitate a broader and more consistent understanding of roles (for example the consistent oversight role).

Recommendations

- 16) We recommend the province review, clarify and update the legislation to reflect fully its intentions and objectives for the TransLink governance model (including clear articulation of regional transportation priorities) and clarify in legislation the roles and responsibilities.**

8.6 The Regional Transportation Commission (the TransLink Commission)

A stronger role for the TransLink Commission would help protect the interests of users and taxpayers and could help enhance customer service and the transparency of decisions and performance levels. As the regulator, the TransLink Commission's mandate should be broadened to include evaluating how the entities in the model are fulfilling their roles as laid out in the governance model and their effectiveness in meeting the objectives the model was created to accomplish. This would bring the TransLink Commission's responsibilities into line with the model governance framework and ensure that users and taxpayers are informed of how well the model is working thereby increasing accountability and transparency.

The TransLink Commission should be made responsible for issuing a public opinion on the following:

- The performance of the Mayors' Council/Transit Authority in carrying out its legislative responsibilities and accountabilities (i.e. Board appointments, Board oversight, approval of compensation plans, etc). The Commissioner's overview would provide an independent perspective on the effectiveness of the Mayors' Council, enhancing accountability.
- The effectiveness of TransLink's strategies. The Commission could increase public confidence in TransLink's strategies by commenting on whether the right things are being done.
- The integration of TransLink's strategies into the provincial transportation plan.
- TransLink's service levels. Currently there are no clearly defined service levels or standards for TransLink. The Commission's review would enhance public awareness and transparency of TransLink's service levels. This may create useful public discussion on the need for balance between transit capacity, cost and service levels.

- TransLink's cost structure and cost reduction activities. The Commission's overview of costs, balanced with his review of service levels would help protect ratepayer and taxpayer interests.
- TransLink's overall progress against its objectives, with recommendations for improvements.

Also, the TransLink Commission could do more verification of the information received from TransLink; this would enhance transparency.

As the TransLink Commissioner would be evaluating the performance of the Mayors' Council/Transit Authority and TransLink, yet is currently appointed by the Mayors' Council, the appointment of the Commissioner should be made by someone outside of the model to ensure the proper amount of independence.

Recommendations

17) We recommend the province strengthen the role of the Regional Transportation Commission to include:

- **appointment by the Lieutenant Governor in Council, to increase independence from the Mayors' Council/Transit Authority;**
- **issuing a public opinion on the performance of the Mayors' Council/Transit Authority in carrying out their legislated responsibilities and accountabilities (i.e. Board appointments, overseeing the Board, approval of compensation plans, etc);**
- **issuing a public opinion on the effectiveness of TransLink's strategies and their integration into the provincial transportation plan;**
- **oversight of costs and service levels; and**
- **greater verification of information provided by TransLink.**

8.7 Public Reporting, Accountability and Transparency

TransLink is accountable and transparent. It is subject to the *Freedom of Information and Protection of Privacy Act*. It undertakes public consultation as part of its planning processes, reports on its operations annually, discloses its financial statements and compensation under the *Financial Information Act*. It also conducts and annually posts customer satisfaction and complaints surveys. In addition, the TransLink Commission provides independent assessments of TransLink. The TransLink Commissioner reported that TransLink's customer satisfaction survey and complaints processes are working well.

9.0 Size, Composition, Appointment Processes and Compensation of the Board, Executive and TransLink Commission

Overall, we found that the size, composition, and appointment process for the TransLink Board of Directors and TransLink Commission were reasonable and complied with the *Act*. We found that Board and executive compensation were slightly high but not excessive. We consider the number of executives in TransLink and its subsidiaries, at 28, excessive.

9.1 TransLink Board of Directors - Size, Composition, Appointment Process and Compensation

TransLink Board Size and Composition

The size of TransLink's Board, at nine, is reasonable and comparable with the Boards of eight public transit operators in other Canadian jurisdictions including Calgary, Toronto and Montreal. The current Board has the mix of skills and experience specified in the *Act*.

TransLink Board Appointment Process

The Mayors' Council is responsible for appointments to and removals from the TransLink Board. The Council engages a Screening Panel for this purpose. Each year, a Screening Panel is appointed with a member representing each of: the province, the Mayors' Council, the Institute of Chartered Accountants of British Columbia, the Vancouver Board of Trade, and the Greater Vancouver Gateway Society.

The Screening Panel is responsible for providing the Mayors' Council with at least five candidates with appropriate skills and experience to fill the vacancies created by the end of the terms of three directors each year. The Panel also recommends the remuneration for the Board.

The Screening Panel determines Director selection criteria after discussion with TransLink's Board and Governance Committee Chairs and the Mayors' Council. Once their responsibilities have been discharged the Screening Panel is dissolved.

This appointment process complies with both the *Act* and the best practice guidelines for appointments for BC Crown Corporations. However, the process limits the Mayors' Council's responsibility for Board member selection which is necessary if they are to be held accountable for the Board and through them TransLink's performance.

Consistent with the earlier discussion, the Mayors' Council/Transit Authority should be responsible for selection and appointments to the TransLink Board. In keeping with best practice, such appointments should continue to be competency based.

Recommendation

- 18) **We recommend the province consider amending the legislation to make the Mayors' Council/Transit Authority responsible for selection as well as appointments to the TransLink Board. The requirement to use competency-based criteria for Board selection should be included in legislation.**
-

TransLink Board Compensation

Overall, the TransLink Board's remuneration is slightly high, but not excessive. The process for determining and setting Board compensation was reasonable and generally consistent with good practice.

According to the *Act*, the Screening Panel is responsible for determining the Board of Directors' compensation. Board Directors are paid retainer fees plus fees per meeting attended. The Board Chair is paid a fixed retainer fee without additional meeting fees. The fees paid to Directors and the Chair are reasonable in relation to other comparable transportation authorities, but slightly higher than the Crown Corporations we compared against, however, the differences are not excessive.

The Chair of the Board received remuneration of \$75,000 for 2008. Directors' remuneration included a retainer of \$25,000 plus meeting fees of \$1,200 for full-day and \$600 for half-day meetings.

We noted these remuneration levels to be somewhat higher in total than the BC Crown Corporations we compared with, when we assumed a similar number of meetings were attended, and in excess of the remuneration levels set in Provincial Treasury Board directives to Crowns.

On the other hand, we found the remuneration of the Chair in 2008 was below the average of the transit operators and other transportation authorities that we compared against. The directors' remuneration was reasonably comparable as well.

We also reviewed the process for setting Board compensation. The process involved an external consultant, and benchmarked against both public and private transportation authorities, mainly public sector entities in the Greater Vancouver region. The process and the selection resulted in a good comparator group for TransLink. This provides more confidence in the results of the process for setting compensation. Overall, we found the process to be reasonable.

9.2 TransLink Executive Size, Composition, Appointment Process and Compensation

Overall, the appointment process of the executive of TransLink and its subsidiaries is reasonable; however the number of executives throughout the organization is excessive. We found the executive compensation levels range from reasonable to high, but not excessively so.

Executive
Appointment
Process and
Compensation

The appointment process of the TransLink executive and its subsidiaries is reasonable while the compensation levels range from reasonable to high, but not excessively so, depending on the position and comparators.

The TransLink Board appoints the TransLink CEO and the TransLink CEO appoints the other TransLink executives. The same executive appointment process applies to the subsidiary companies, except that in the subsidiaries the CEOs are members of the companies' three-member Boards.

In this case, while our preference is that the CEOs are not members of their respective Boards, we recognize that the risks are lower given that the subsidiary companies are wholly-owned-subsidiaries and accountable to the TransLink Board.

The CEO's compensation was approved by the TransLink Board. The executives' incentive pay was based on performance objectives and achievements approved by the Board for the CEO and approved by the CEO, but not the Board, for the other executive positions. Ideally, all executive compensation should be approved by the Board after recommendation by the CEO. The process to determine executive compensation included external benchmarking against BC Hydro, ICBC, Toronto Transit Commission, BC Ferries, the GVRD and the ministry.

We compared the 2008 executive compensation to that paid by four of BC's largest public sector entities that were ranked higher than TransLink on BC Business magazine's list of the top 100 BC private, public, and Crown corporations in terms of revenue – BC Hydro, ICBC, BC Lottery and WorkSafe BC. They were ranked 6th, 8th, 13th, and 19th respectively; TransLink was ranked 29th. We also compared against four other public transit operators in other Canadian jurisdictions.

While the compensation of the CEO and some other executive was comparable to these Crown Corporations, and higher than the other transit operators, when size and complexity of the organization are considered, the amounts become more reasonable.

Under the TransLink executive compensation plan the TransLink CEO earns an annual base salary of \$325,000 and has the opportunity to earn up to 40% of annual salary as bonus performance compensation each year. The CFO's compensation under the plan is a base salary of \$247,500 and a bonus opportunity of up to 15% of annual salary based upon performance. In 2008 the actual CEO and CFO's compensation including base and bonus was approximately \$189,500 and \$242,500 respectively. Neither individual were in the position for the full year 2008.

The average remuneration for the CEOs and CFOs of the four public sector entities we compared against was \$455,000 and \$341,000. Given the relative sizes of the entities, the TransLink amounts are considered reasonable.

In comparison to the group of transit operators, TransLink CEO's remuneration was higher than all the comparators. However the operations varied in size (by ridership) and breadth of responsibilities. When these factors are considered, TransLink CEO's remuneration is more comparable.

TransLink executive bonuses for 2008 were calculated, but not paid, pending the outcome of funding surety. If the bonuses were to be paid, total compensation would be less comparable with the other transit operators. Regardless, for a few executive positions below CEO level, the compensation was high but not excessively so.

Say for Pay

A good business practice being introduced in the private sector, commonly referred to as "say for pay", provides shareholders the right to vote on whether or not to approve a company's executive compensation program. Through such a mechanism, shareholders can encourage the use of controls on executive compensation, such as hard caps, and thereby help ensure the level of executive compensation remains reasonable.

In keeping with this practice, the province could consider giving the Mayors' Council/Transit Authority the right and responsibility to vote annually whether or not to approve the executive compensation program.

Appendix 2 provides a summary of some best practice principles for compensation of public sector management that can be used by Boards/Shareholders to guide management compensation programs that link pay and performance.

Recommendation

19) We recommend the province consider amending the legislation to give the Mayors' Council/Transit Authority the right and responsibility to vote annually whether or not to approve the executive compensation program (possibly non-binding and possibly including hard caps on senior executive compensation). Legislation should require the use of public sector guidelines on compensation.

Executive Composition and Size

The number of executive members within the TransLink organization is excessive, at 28.

This includes the executive from the divisions of TransLink, which have been structured as subsidiaries. The fact that the operating companies, Coast Mountain Bus Company and British Columbia Rapid Transit Company, are independent legal entities with their own Boards and CEOs partly contributes to the relatively large number of executive.

The 28 executive members is concerning when considering the overall value of executive compensation.

Even if the subsidiaries are ignored, the number of executive in TransLink, at 12, remains relatively large compared to the public transit operators in other Canadian cities mentioned above and the four BC Crown agencies we considered from the BC Business magazine's list of the top 100 BC private, public, and Crown corporations. The general range is 8 to 10.

TransLink has commissioned a process review of which one of the expectations is to identify duplication of activities within TransLink and its subsidiaries.

Recommendation

²⁰⁾ We recommend TransLink, following the outcome of its review, rationalize the executive team size in TransLink and its subsidiaries.

9.3 Size, Composition, Appointment Process and Compensation of the TransLink Commission

The Commission's size, composition, appointment process and compensation are reasonable and compliant with the *Act*. As the *Act* requires, the Mayors' Council appointed a Commissioner for a 5-year term that began June 2008. The TransLink Commissioner carries out his responsibilities on a part-time basis.

While there are currently no deputy commissioners, the TransLink Commissioner is commonly supported by one senior advisor/consultant and a communication manager.

In fiscal 2008, the TransLink Commissioner's remuneration was approximately \$46,000 paid on a per-diem basis for his services, plus approximately \$10,000 in expense reimbursement. Total 2008 costs of the office were approximately \$86,000, including the fees paid to the TransLink Commissioner as well as remuneration for those who provided assistance

10.0 TransLink Operational Effectiveness

Overall, TransLink provides good transportation service at a relatively high cost. The system expansion during the past few years has resulted in decreased efficiency and a rapid growth in debt. Action is required now to focus on operations instead of expansions and to maximize cost containment, operating efficiency and revenue generating efforts immediately and for the next few years.

10.1 Operating Costs and Financial Management

TransLink has experienced a period of significant expansion over the last few years. Major capital investments have been made in fleet growth and expansion of rapid transit service and road infrastructure. TransLink's investments in expansion have been expensive and have put considerable financial pressure on its current operations. TransLink advise they are facing a structural deficit of over \$130 million per year; i.e. their revenue streams are projected to fall that much short of their increased operating expenses and carrying costs.

Public transportation systems typically require some form of ongoing financial support in addition to fares. TransLink's current rate for fare box recovery to cost is 55%. That is, just over half the costs of operating a transit vehicle are recovered at the fare box, on average. The other 45% of the cost needs to be funded from sources other than fares.

This means that as TransLink expands its systems, more and more financial support is needed from sources other than fares. The fact that TransLink has been expanding into geographical areas that are less populated is likely to exacerbate that effect because those areas are likely to have a significantly lower fare box recovery rate.

It should be noted that tax revenues do not automatically increase with expansion and require the implementation of higher rates to offset the fare box shortfall.

TransLink's financial situation is further stressed because some of the new infrastructure is expected to cost more than the revenues it will generate.

For example, the cost of operating the Canada Line (net of bus fleet operating efficiencies) is expected to exceed the additional system revenue it generates until 2025, with costs exceeding incremental revenues by \$14 million to \$21 million for most years until then. (We note that those calculations do not include the anticipated, but unmeasured, revenue increase due to increased demand across the wider integrated transportation system because of the implementation of the Canada Line).

We were advised that while TransLink had both the Evergreen and Canada Lines in their long term plans, the region's and TransLink's priority was the Evergreen line. The provincial priority was to participate in the Canada Line, in part because they felt it had a stronger business case and because of the desire to have the line available for the Olympics. Given the provincial and federal funding availability, TransLink proceeded with the Canada Line.

We noted that the Golden Ears Bridge project is projected to have no significant negative impact on TransLink's cash or operating cash flow.

The majority of the \$130 million structural deficit faced by TransLink is a result of factors other than Canada Line, such as the increase in the operational cost of the bus fleet, particularly into lower ridership, geographically sparse areas.

As TransLink is ultimately responsible for their own financial well being, actions should have been taken to contain rising costs through service rationalizations and other means to mitigate or prevent the known structural deficit that was being predicted.

The investments in expansion add pressure to TransLink's structural deficit situation through the greater cost of operating the larger system as well as the increased debt servicing costs.

TransLink's debt has more than tripled since 2005. With revenues not growing as fast as operating costs, TransLink must use more of its resources for debt servicing leaving even less for operations.

Interest Expense
as % of
Revenues

Figure 10.1a shows how TransLink's interest expense as a percentage of revenues (excluding capital contributions and interest income) has risen from 2008 to 2009.

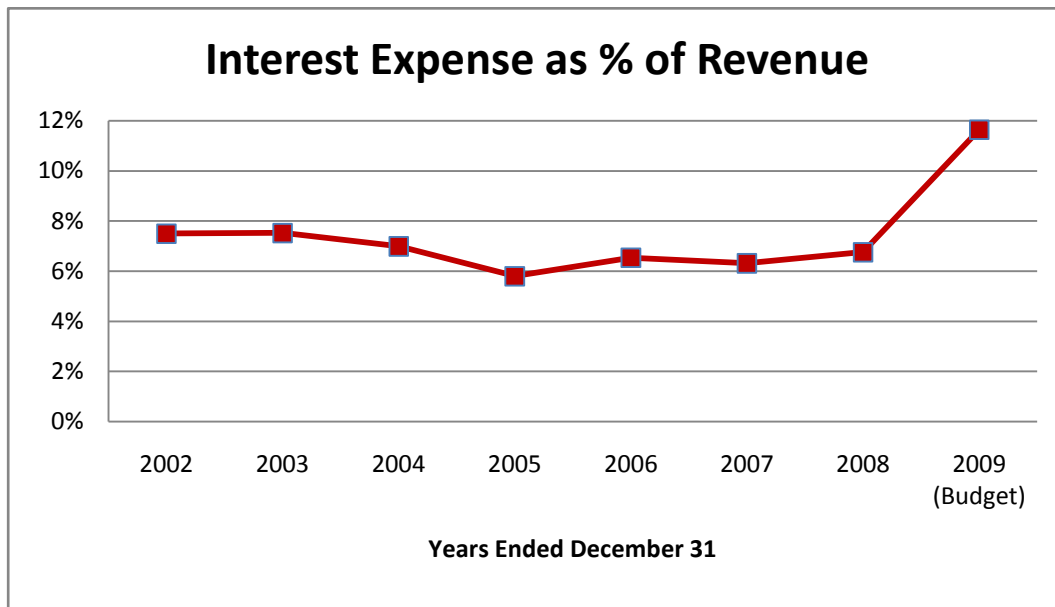


Figure 10.1a

Debt Service
Coverage Ratio

As Figure 10.1b shows, TransLink's debt service coverage ratio, the organization's ability to pay its debt costs, has been above 1.0, but it dropped below 1.0 in 2008. A ratio below 1.0 indicates that earnings (after operational or capital costs) were insufficient to meet debt servicing costs.

Furthermore, TransLink's net debt as a percentage of revenue increased from 113% in 2005 to 295% in 2008.

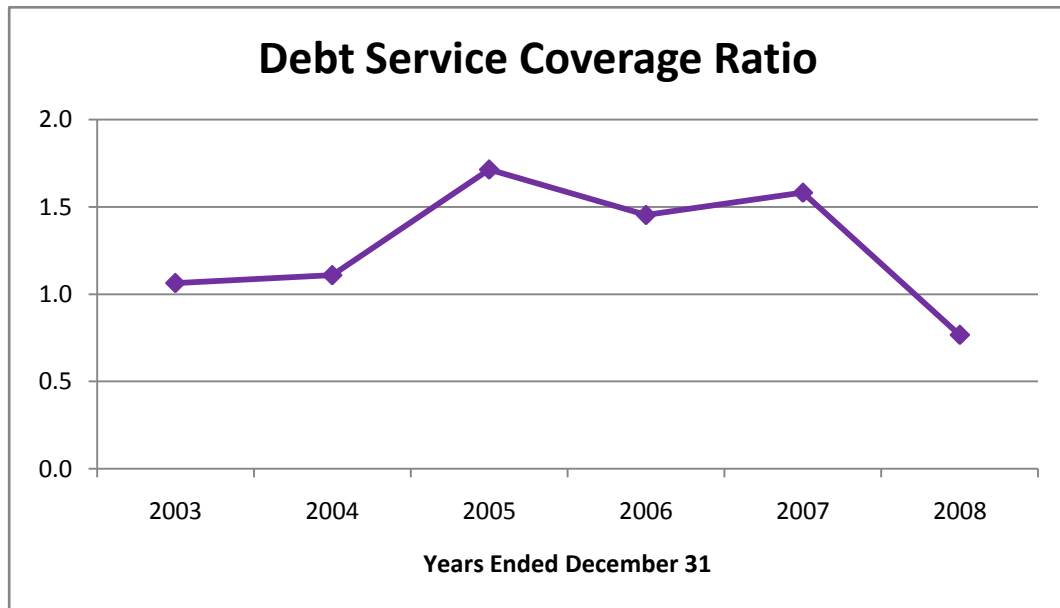


Figure 10.1b – Calculated as earnings before debt interest, amortization and capital contributions divided by (debt interest and principal payments).

Managing the debt load is becoming an increasing priority and focusing efforts on the operational cash flow by maximizing operating revenues and minimizing operating costs will be paramount over the next several years.

Capital Asset
Management
and Financing

While, TransLink's individual project capital management process management compares well against government's Capital Asset Management Framework, one area for improvement is that operational business cases for capital items do not indicate how ongoing operating costs are to be funded. This observation may be symptomatic of the funding challenge currently facing TransLink.

We also noted that operating and capital budgets are currently combined. Separating operating budgets from capital budgets would add clarity to financial decision-making.

10.1.1 Operating Expenses

Operating Expenses as % of Revenues

Operating and admin expenses are increasing in excess of revenues, general inflation and ridership. Therefore, further increases in revenue, cost reductions and/or service reductions are needed to balance the budget. As shown in Figure 10.1.1a, the increasing ratio between operating expenses and operating revenues can be attributed to fares increasing more slowly than inflation while actual operating expenses have exceeded the rate of inflation.

We were advised that, reasons for higher actual operating expenses include:

- expanding services faster than ridership demand;
- escalating vehicle maintenance costs;
- energy prices;
- policing costs; and
- the increasing cost of labour.

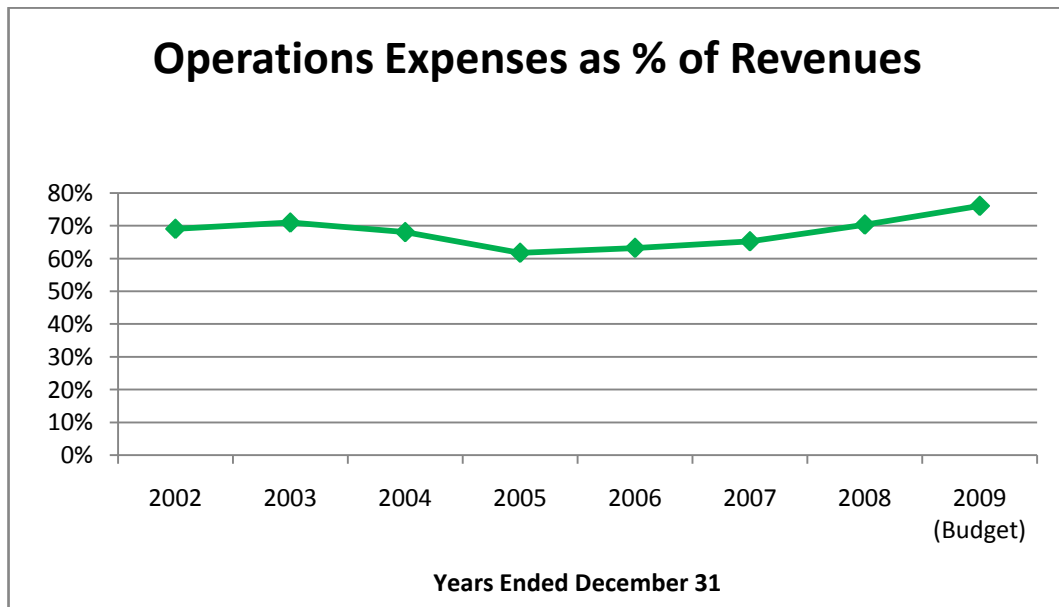


Figure 10.1.1a - Operations expense (including maintenance) as a percent of operating revenues (excluding capital contributions and interest income) are increasing relative to revenues.

Operational Expenses vs. Ridership and Inflation

As shown in Figure 10.1.1b, Operational expenses increased at approximately the same rate as ridership until 2007, and then expenses surpassed ridership growth by approximately 10%.

We were advised that the expansion strategy created increased operational expenses where additional services were added to less populated regions. Ridership and associated revenue are lower on these routes, yet the cost of operating a bus is relatively constant. Overall, the growth or expansion in operational expenses exceeded inflation by a multiple of 3.5 times.

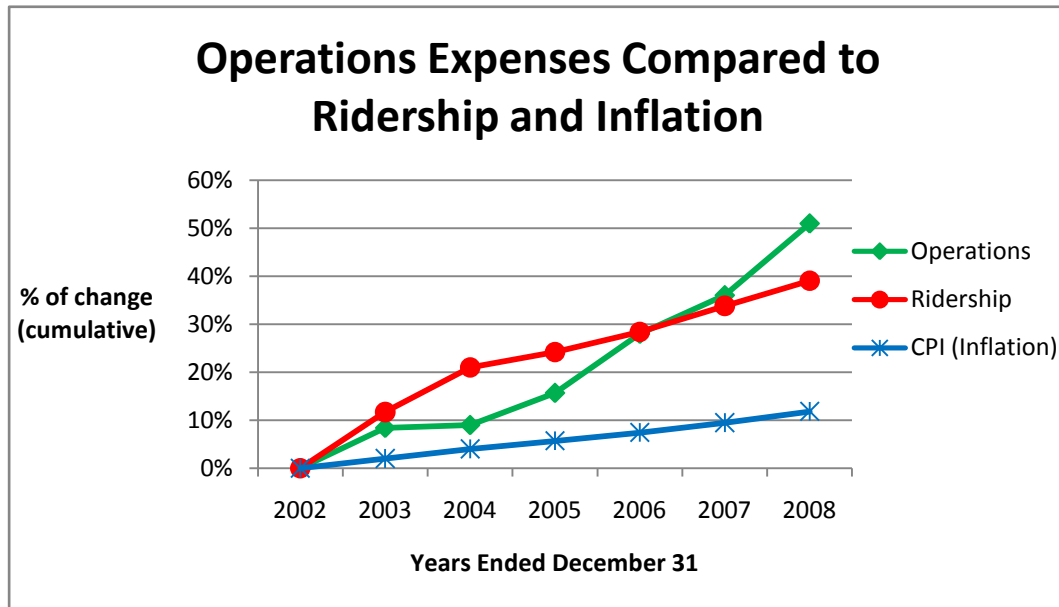


Figure 10.1.1b - displays the actual operational expense, ridership and inflation (CPI) from 2002 to 2008.

Cost and Fare
per Rider

The following Figure 10.1.1c shows that the average cost per rider increased by 20.6% from 2005 to 2008, while the average fare per rider increased by 8.9%. TransLink did not impose an increase of fares between 2005 and 2007 and the fare increase in 2008 did not cover the cost of inflation which had occurred between 2005 and 2008. As well, the additional costs of expansion into less populated regions were not met with equivalent ridership levels to maintain a constant cost per rider. Therefore, the average cost per rider increase of 20.6% was more than double that of the average fare per rider increase of 8.9%.

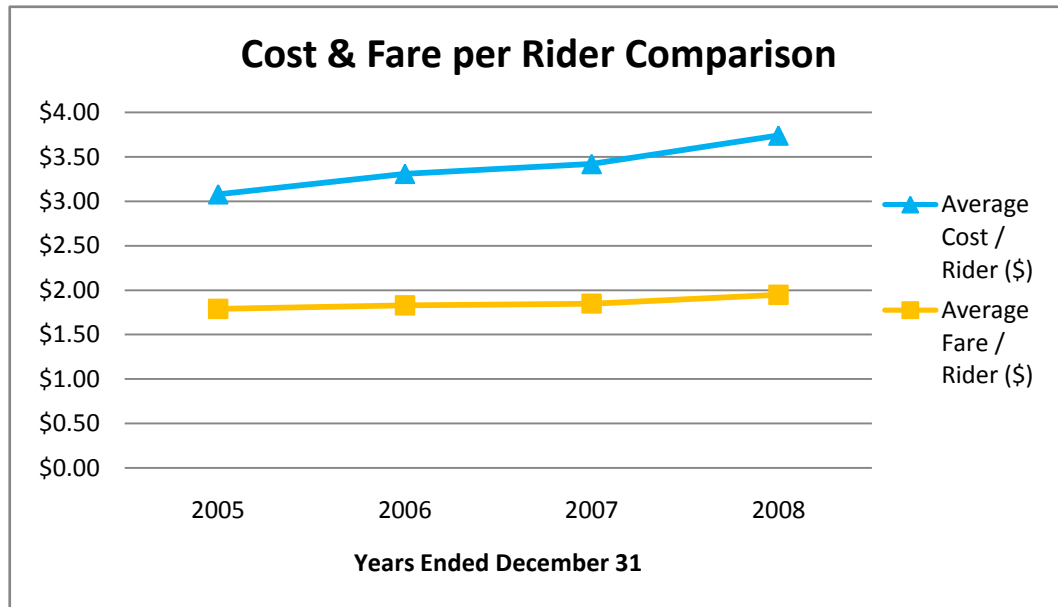


Figure 10.1.1c - Average costs per rider increasing more than average fare per rider.

In our review, however, of adult cash fares for Calgary, Toronto, Ottawa and Montreal, we noted a range of \$2.50 to \$3.00. TransLink's adult cash fare is currently, \$2.50.

10.1.2 Administration Expenses

TransLink's administration costs have been significantly increasing at a pace greater than ridership and inflation, TransLink's administration costs increased by 101% between 2002 and 2008. Figure 10.1.2a indicates that administration costs have increased by a rate more than double that of ridership and approximately seven times that of inflation.

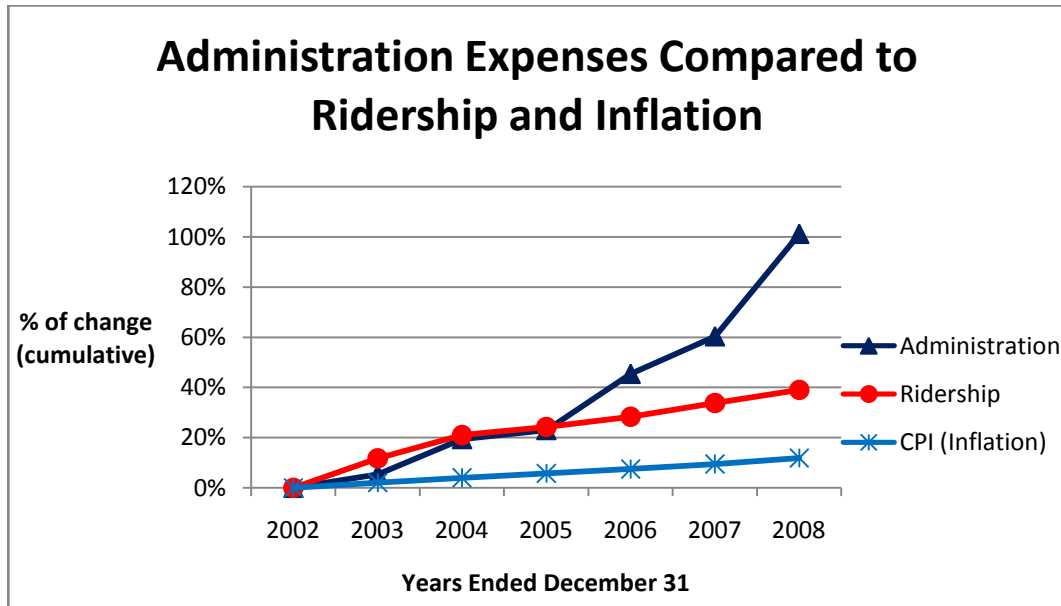


Figure 10.1.2a - displays the actual amounts for Administration expense, ridership and inflation (CPI) from 2002 to 2008.

Strategies for Cost Containment

Prior to 2008, few steps were taken to reduce costs, reflecting TransLink's strategy of expansion. Since 2008 a few cost containment activities have taken place but these activities are specific and minor rather than organization-wide. We noted some efforts by the operating divisions to reduce costs such as the use of contractors for rail division activities. Recent actions included freezing executive salaries in 2009 and implementing hiring restrictions for TransLink and its subsidiaries.

Administration
Expenses as %
of Revenues

Administration expenses, as shown in Figure 10.1.2b, have for a number of years been between 3.0% and 3.4% of revenue but are forecast to be 4.7% of revenue for 2009.

We would have expected that cost containment measures identified by TransLink would have resulted in a decline in this measure.

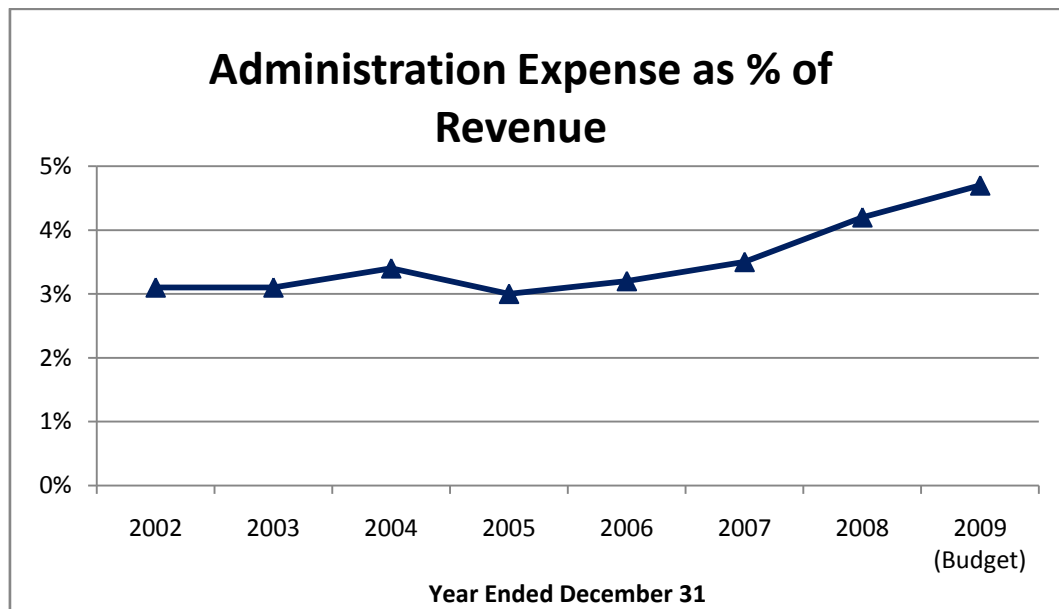


Figure 10.1.2b

Significant savings will likely be realized only through service rationalization as bus operational costs are a significant proportion of total overall operational costs. We discuss this further in section 10.2.1.

We found no specific cost reduction targets in place for 2009, although the 2009 budget was reviewed and the planned budget increase was reduced. Overall there was still a year over year increase in budgeted expenses. An organizational and process review was commenced, as well. Cost reduction targets are planned in the 2010 budget. However, total costs in 2010 are still projected to be 2.7% higher than 2008 actual costs.

Recommendation

21) We recommend that TransLink focus on effective cost-containment and set specific cost reduction targets.

Risk
Management

Overall, TransLink is identifying its key risks. For most of the risks, mitigation strategies are in place. The organization is reviewing actions taken and updating the risk registers to reflect the current situation.

There is a significant risk related to TransLink's use of the Municipal Finance Authority (MFA) for its debt issues. TransLink has no assurance that MFA will provide long-term financing. MFA have indicated they will provide up to \$250 million of short-term financing, which TransLink estimates will suffice only until early 2010. MFA have also stated they will provide long-term financing if a fully-funded plan is approved and they have established a tentative date to consider TransLink's request for long-term financing in late November

The deadline of October 31 for the Mayors' Council approval of a 10-year plan is after the MFA debt issuance date. This may impact TransLink's ability to borrow for the 10-year plan on a timely basis. For TransLink to obtain financing elsewhere would be more costly as MFA provides a better rate and TransLink does not incur as much costs in the issuance.

Policies and
Practices

TransLink's procurement approaches are fair, transparent and in line with public sector best practices with one exception. TransLink procurement policy does not require a post-completion evaluation to be conducted. Post-completion evaluations are important for quality assurance and provide an excellent learning and development tool.

10.2 Service Delivery

TransLink's service delivery model has been based on an expansion strategy which included extending infrastructure and services into less productive regions with the intention of capturing market share by increasing demand and public transit availability, while seeking to achieve key social and environmental objectives.

We noted that TransLink has a customer service focus, that customer satisfaction and complaint processes prescribed in the *Act* are in place and TransLink's levels of customer service compares relatively well to other Canadian transportation providers.

However, the capital and operating cost of the expansions in the service delivery model have been expensive and the current taxation funding streams are insufficient to ensure TransLink's financial sustainability.

As a priority, TransLink's provision of service needs to be aligned with costs and available revenues.

Funding

The 2007 governance review suggested that TransLink generate revenues through a range of taxation streams which are more balanced, less reliant on property taxes, and sustainable. The *Act*, passed subsequently, gives

TransLink taxation powers including property tax, parking tax and fuel tax as well as the power to implement certain fees to users of roads.

Currently implemented taxation streams include fuel tax, parking tax and property tax. When combined with fare box revenues, these streams are insufficient to ensure TransLink's financial sustainability.

Other revenue streams available to TransLink are tolling on designated (new or improved) roads and bridges as well as a motor vehicle levy. However, provincial support may be required to implement the vehicle levy on a cost effective basis.

Revenue
Generation

TransLink's revenues are considerably short of its current financial obligations. Legislation requires that TransLink not incur deficits, so revenues must be increased or costs cut to balance the budget. The Mayors' Council must approve any increases in existing taxes or implementation of currently unused taxes. Alternative 10-year plans have been put forward to the Mayors' Council as options to determine the funding available to TransLink. By the end of October 2009, the Mayors' Council is to have decided which plan to proceed with. Then TransLink will be able to proceed with the revenue generation opportunities outlined in the selected plan. If the Mayors' Council does not approve any of the supplemental funding plans then TransLink will have to make substantial cuts to avoid a deficit.

The 2007 governance review suggested that TransLink's revenue streams should, ideally, come one-third from users of the system, one-third from vehicle owners, and one-third from home owners. However, the Mayors' Council has said it is opposed to property tax increases.

Fuel tax revenue is considered to have peaked (it will be maximized if the \$130 million supplemental plan is approved) and fares are seen to be at close to maximum levels.

TransLink could implement its other legislated options for revenue generation. TransLink management informed us that progress on additional income streams was forestalled by the organizational uncertainty that followed from the announcement and commencement of the governance review in 2007.

TransLink could charge a vehicle levy (also known as a Transportation Improvement Fee). In 2000, TransLink approved a vehicle levy but it was disallowed by the government of the day. At present, TransLink's reason for not having done so is that they have yet to obtain an agreement with ICBC to collect the levy for them, or to find an alternative collection method that is cost effective.

One of the funding supplements recently prepared by TransLink would fully utilize the vehicle levy in the future, but TransLink management are of the view that provincial authorization and access to ICBC data will be required to enable this to happen.

TransLink management informed us they will be consulting widely on further taxation opportunities for implementation in 2013.

Future revenue or taxation methods should be fair, simple and straightforward. A transparent taxation method helps to build acceptance and commitment amongst stakeholders and taxpayers. In addition, simple taxation systems are easier and less costly to administer.

Recommendation

22) **We recommend TransLink fully demonstrate that cost containment strategies are in place and existing revenue streams are maximized before exploring alternative sources of revenue. The province could consider raising the existing limits in the revenue streams currently available to TransLink in order to maintain the guiding principle of balance between the types of revenue streams (1/3 from existing vehicle related taxes, 1/3 property taxes, 1/3 other revenues such as fares, advertising, land, etc).**

10.2.1 Productivity

Capacity/Costing

For our review of system capacity, we found that regular service hours increased by 12% between 2004 and 2008, whereas average rider utilization of this expanded service declined by 3.6%. This indicates that the extra supply of service has greatly exceeded demand. The challenge remains to balance service delivery needs with costs.

Also, TransLink's operating cost per rider-kilometer has increased 19% from 2005 to 2008, well above the general inflation rate. An increase in the number of available and unfilled seats would contribute to a higher cost per rider kilometer.

The following productivity measures indicate that TransLink is a high cost operator compared to other transit systems:

- cost per rider – TransLink's cost per rider is \$3.44 (other operators' costs ranged from \$2.11 to \$2.70 per rider) This is relatively high, likely due to lower ridership levels; and
- cost per rider-kilometre TransLink's cost is \$0.29 per Km (other operators' costs ranged from \$0.19 to \$0.29 per Km). This is likely an indicator of relatively low ridership levels over the distance.

We found that TransLink was a relatively efficient operator in terms of operating costs per vehicle hour and per kilometer, based on a comparison with other Canadian transit service providers. This efficiency was at least in part due to TransLink being a lower cost user of fuel and energy to operate its vehicles.

It is noted that ridership has increased by 38.5% between 2002 and 2008, faster than population growth of 7.5%, which indicates that more people are taking public transit. This is consistent with the goals of TransLink to encourage more residents to take public transit rather than drive.

We attempted to determine levels of ridership or route capacity to identify other possibilities for cost containment and efficiency while balancing service level needs, but we found the available data of limited value. TransLink informed us they do not cost by route, but rather over the entire transit system using cost per service hour and cost per kilometre as the key drivers. As a result, TransLink has useful broad system-wide information, but, to manage their costs and conduct service rationalisations they require more specific information. Currently, TransLink reviews, reassigns or reallocates resources (such as fleet and service hours) to lessen or increase service provided, rather than cancel service on a route. The only routes cancelled since 2001 followed the introduction of the Millennium and Canada Lines.

In an effort to resolve these challenges, TransLink has invested in an automated passenger counting system for its buses and is implementing Smartcard technology to be supplemented by fare gates at train stations. This will capture rider travel data to inform future planning and cost efficiency analysis.

Some productivity improvements have been implemented over recent years, such as conversion of 15% of the system to smaller community shuttle buses. TransLink is considering a review of existing service levels and service rationalization.

Ongoing service rationalization reviews are required to ensure that appropriate service levels are maintained, while making the best use of ratepayer provided taxation revenue. Also, as bus operating expenses represent a significant proportion of total operating expenses, bus service rationalization reviews will, likely, provide the greatest opportunity to reduce total operational costs.

Recommendation

23) We recommend that TransLink conduct ongoing service rationalizations to ensure service levels and ridership are optimised, while minimising costs.

10.2.2 Customer Service

The customer satisfaction and complaint processes prescribed in the *Act* are in place. TransLink has a customer service focus, tracks and measures responses to complaints from bus riders, and uses the results as input for schedule adjustments.

Strategies have been developed to ensure service quality is monitored. The goal is improvement while containing costs and generating revenues.

Customer
Service
Measures

Customer satisfaction ratings have been fairly stable, dropping slightly from 73% to 70% since 2006. TransLink ranks relatively well compared to other Canadian service providers reviewed. We note also that the volume of TransLink's customer complaints improved by 25% from 2007 to 2008.

10.2.3 Alternative Service Providers (ASPs)

TransLink is quite active with ASPs opportunities. TransLink continually explores the prospects for contracted services.

They have considered and contracted key operational activities such as HandyDart and the Canada Line as well as non-operational activities such as landscaping and the process review. The size of the contracts involved range from smaller contracts such as service hosts to billion-dollar projects such as the Golden Ears Bridge and Canada Line.

11.0 TransLink's Alignment with the Governance Framework

As noted in section 1.0 above, A Framework for Transportation Governance, one of the objectives of this review was to identify and consider options available to the province that, while respecting the organizations' independence, ensure that TransLink and other models for independent, regulated services that the province may create in future are effectively structured to:

- 1) Protect ratepayers' interests with minimal administration costs, including hard caps on compensation levels for senior executives and Board members;
- 2) Protect clearly mandated customer service levels;
- 3) Minimize cost and maximize benefits to BC taxpayers of provincially funded grants; and
- 4) Improve transparency and public accountability for decisions and performance levels.

We are of the view that the current governance model for TransLink can be modified to more clearly fulfil those four principles while respecting TransLink's independence. Our preceding recommendations and which of the four listed principles they support are presented in the following table.

11.1 Additional Option for Governance of TransLink

When dealing with government-created independent entities, the government always has the option of bringing these entities into the Government Reporting Entity (GRE), under government control, if the entity is considered to be insufficiently fulfilling the province's public service mandate or inadequately meeting the needs of users and taxpayers.

TransLink has had its model reviewed and changes made on more than one occasion. Given this history and that TransLink has a more complicated governance structure; the province could consider bringing TransLink into the GRE if it has not been able to be more effective at meeting the needs of users and taxpayers after implementing the recommendations in this report. There would be a number of positive and negative implications of such a decision. We have not identified and assessed those implications as that was outside of the scope of this review. In keeping with the purpose and objectives of our review, our report assumes that TransLink will continue as a government-created independent model into the future.

TransLink – Summary of Recommendations

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency and Accountability
<p>About The Mayors’ Council, we recommend the province consider amending the legislation to clarify the roles and responsibilities of the Mayors’ Council/Transit Authority. The roles and responsibilities to be clarified include:</p> <ul style="list-style-type: none"> • establishing clearly that the Board is accountable to the Mayors’ Council/Transit Authority, including removal of members from the Board; • overall responsibility for the performance of the Board; • providing broad strategic direction to the Board; • providing oversight over the Board; • establishing the remuneration of the Board members; • establishing the terms of service of the members of the Board; • reviewing and approving or rejecting long-term, strategic and direction setting proposals from the Board and management; and • the Mayors’ Council/Transit Authority needs to act as a shareholder and not as management. 	<p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p>	<p style="text-align: center;">✓</p>	<p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p>	<p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p> <p style="text-align: center;">✓</p>

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency and Accountability
<p>We also recommend the province:</p> <ul style="list-style-type: none"> allow for provincial representation, to a maximum of 20%, at the shareholder group (Mayors' Council/Transit Authority) in order to facilitate active involvement and strategic alignment among the government bodies. The revised group could be re-named "the Transit Authority" to reflect its broader membership; make the Mayors' Council/Transit Authority responsible for selection as well as appointments to the TransLink Board. The requirement to use competency-based criteria for Board selection should be included in Legislation; and give the Mayors' Council/Transit Authority the right and responsibility to vote annually whether or not to approve the executive compensation program (possibly non-binding and possibly including hard caps on senior executive compensation). Legislation should require the use of public sector guidelines on compensation. 	✓		✓ ✓ ✓	✓ ✓
<p>About TransLink, we recommend the province:</p> <ul style="list-style-type: none"> review, clarify and update the legislation to reflect fully its intentions and objectives for the TransLink governance model (including clear articulation of regional transportation priorities) and clarify in legislation the roles and responsibilities; 	✓	✓	✓	✓

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency and Accountability
<p>We also recommend the province:</p> <ul style="list-style-type: none"> provide for greater flexibility and consultation within the planning framework by revising the legislation and expanding the timelines to allow for dialogue among stakeholders; and shorten the timeframe covered by the plan. For example; a shorter 3 to 5 year defined funding plan with a 10-15 year outlook may be more appropriate. 	<p>✓</p> <p>✓</p>	<p>✓</p>	<p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p>
<p>About TransLink, we recommend they:</p> <ul style="list-style-type: none"> fully demonstrate that cost containment strategies are in place and existing revenue streams are maximized before exploring alternative sources of revenue. The province could consider raising the existing limits in the revenue streams currently available to TransLink in order to maintain the guiding principle of balance between the types of revenue streams (1/3 from existing vehicle related taxes, 1/3 property taxes, 1/3 other revenues such as fares, advertising, land, etc); conduct ongoing service rationalisations to ensure service levels and ridership are optimised, while minimising costs; focus on effective cost-containment and set specific cost reduction targets; and following the outcome of its review, rationalize the executive team size in TransLink and its subsidiaries. 	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p>	<p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p>

Recommendations	1. Ratepayers	2. Customer Service	3. Taxpayers	4. Transparency and Accountability
<p>About the TransLink Commission, we recommend the province strengthen the role of the Regional Transportation Commission to include:</p> <ul style="list-style-type: none"> • appointment by the Lieutenant Governor in Council, to increase independence from the Mayors' Council/Transit Authority; • issuing a public opinion on the performance of the Mayors' Council/Transit Authority in carrying out its legislated responsibilities and accountabilities (i.e. Board appointments, overseeing the Board, approval of compensation plans, etc); • issuing a public opinion on the effectiveness of TransLink's strategies and their integration into the provincial transportation plan; • oversight of costs and service levels; and • greater verification of information provided by TransLink. 	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>	<p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p> <p>✓</p>

Appendix 1 – Broad Governance Roles and Responsibilities

In Section 1.0, Diagram 1A shows a comparison of the governance components in four different types of organizations. This appendix provides a description of the broad governance roles and responsibilities we would expect of each component in the framework for transportation governance.

Shareholder / Overseer

- Owner of share(s), as applicable.
- Appointment of, removal of and establishing remuneration for Board of Directors of the operating entity.
- Provision of broad, strategic direction to Board of Directors of operating entity.
- Oversight of Board of Directors of operating entity.
- Approval of framework for executive compensation.
- Ultimate accountability for operating entity.
- Fulfill any responsibilities under enabling legislation (e.g. statutory decision-making powers).
- Represent/reflect the view of the constituents.

Operating Entity Board of Directors

- Meet fiduciary responsibility to act in the best interests of the organization, including the financial and operational sustainability of the organization.
- Establish framework for executive compensation.
- Hire and terminate the CEO, review CEO performance, set CEO compensation.
- Approve the strategies, policies and plans necessary to fulfill the shareholder(s)/ overseer's direction.
- Monitor and report on organization's progress in fulfilling shareholder(s) / overseer's direction and informing shareholder(s) / overseer of any significant variances from plan.
- Ensure organization is meeting any statutory and/or regulatory requirements.

Operating Entity CEO / Executives

- Manage organization's daily operations under the Board's stewardship and direction.
- Provide leadership, general supervision, management, and control of the organization's day-to-day operations in accordance with Board-approved plans and policies.
- Manage organization to ensure business plans are effectively implemented, results monitored and reported to the Board, and financial/operational objectives attained.
- Provide leadership and vision in developing the strategies and plans necessary to realize operational objectives.

Regulator – with Statutory Authority to:

- Protect the interests of ratepayers and customers balanced with the financial and operational sustainability of the regulated organizations or systems.
- Review, provide opinions on plans and approve or reject fare applications submitted by the regulated organization.
- Monitor and report on the level of customer service and satisfaction and any other legislated mandate, e.g., competitive approach to carrying on business.
- Provide the public opportunities for input into the performance and cost of regulated organization via public hearings, written submissions, etc.
- Support and provide mechanisms for open and transparent disclosure to the public on matters within the purview of the regulator.

Mechanisms for Protection of Government / Taxpayers' Interests

Varies according to type of entity:

For Crown Corporations or other entities that are part of the government reporting entity, the provincial government exerts direct control over the organization by virtue of its role as shareholder / overseer. This oversight role allows for government to require these entities to follow specific policies and/or directions from government (e.g. compensation caps).

For organizations outside of the government reporting entity, direct control is not an option, as it would result in a change of status (from independent to part of the government reporting entity under generally accepted accounting principles). In this case, mechanisms for the protection of government / taxpayers' interests include:

- Performance-based contracts or other agreements where funding (operating and/or capital) is provided by government to the entity;
- Legislative or regulatory requirements in such areas as safety, environmental protection, labour relations, land use, consultations (with first nations; with the public; with governments – local, regional, provincial, federal), public disclosure, etc.;
- Negotiate and collaborate based on shared interests, and
- Public policy as reflected in such things as long-term economic and capital infrastructure plans and initiatives.

Appendix 2 - Principles of Public Sector Management Compensation

This appendix provides a summary of relevant principles for compensation of public sector management. These principles are drawn from two sources: the Public Sector Employers' Council's *A Guide to Excluded and Executive Compensation in the BC Public Sector* (July 2009) and the Canadian Coalition for Good Governance's *Executive Compensation Principles* (2009).

These principles are developed to balance taxpayers' ability to pay and cost effectiveness while allowing flexibility to management on how it does business. The principles can be used by Boards/Shareholders to guide management compensation programs in a way that links pay and performance.

Sustainability

- The compensation plan, including the components and levels of compensation, is consistent with the organizational objectives, and in an affordable level that would allow the organization to deliver services in the most efficient and effective way over the long term.
- Effective succession planning reduces paying for retention.

Labour Market Comparability

- Management compensation programs should balance affordability and labour market competition to allow the organization to attract and retain competent and effective management;

Accountability

- An informative and guiding compensation plan is in place describing positions covered, compensation range, policies, terms on incentive pay, benefits, market comparability study, etc;
- The compensation plan is approved by the Minister / Board / Shareholder as a legally enforceable compensation standard;
- Pay for performance should be a large component of executive compensation that is truly variable dependent on performance (i.e. stretch targets) and that is not effectively base salary; and
- Compensation should focus on key measures of corporate performance.

Transparency

- Legislative requirements are in place for disclosure of compensation levels exceeding certain thresholds. The *Public Sector Employers Act* requires disclosure of public sector employees earning a base annual salary over \$125,000. The *Financial Information Act* requires disclosure of remuneration when annual base salary is over \$75,000.

Effective compensation disclosure should have all of the following four characteristics:

- Easy to find;
- Easy to understand;
- Accurate and complete; and
- Presented in context so it has meaning.

Variable Incentive Pay Compensation Plans

Variable incentive pay compensation plans are important instruments employers may use to incent superior performance from executive and senior staff. Some employers use these plans as a human resources tool to recruit and retain staff. As such, while variable incentive pay plans can play an important role in an employer's total compensation approach, such plans should reward the appropriate levels of effort, performance and results.

The guidelines provide that:

- award payment levels should be linked to performance achievement levels, ensuring bonus payments are tied to performance measured against service or business plans/shareholder letters of expectation, and individual performance measures;
- awards should not be counted as pensionable earnings; and
- awards are only provided for superior performance, including a provision for a corporate trigger whereby awards can be withheld for inferior corporate performance.

Overall Incentive Plan Principles

- Incentive awards made under the variable incentive pay plan should be re-earnable and not guaranteed from year to year.
- Incentive awards should be designed to reward superior achievements.

- Incentive awards should be provided to reward employees for their contribution to organization's success.
- Incentive awards for a given (e.g. annual) performance period should be delivered in lump sum cash payments.
- Incentive awards should not be considered pensionable earnings.

Performance Measures

Performance measures should demonstrate the delivery of clear benefits to the shareholder and must be based on the following principles:

- Targets must demonstrate value to the shareholder with a direct link to the employers Service or Business Plan.
- Targets should include a significant weighting (e.g. 30% to 50%) for financial performance (i.e. net income along with a range of other key financial indicators must be included).
- Targets, other than net income, should be controllable by the employer.
- Targets should include relative as well as absolute measures.
- Targets should be simple and transparent (e.g. not too many targets).
- Targets should include a mix of short-term and longer-term objectives.

Award Levels

Variable incentive pay compensation plans should define three levels of award:

- i. A minimum level of achievement known as a "threshold" level. To merit this award, Service or Business Plan targets (which should incorporate a modest element of "stretch") must be achieved. There should be an 80 - 90% chance of this level being achieved.
- ii. A superior or "stretch" level of achievement known as a "target" level. To merit this award, Service or Business Plan targets must be exceeded. There should be a 60 - 80% chance of this level being achieved.
- iii. A vastly superior or "super stretch" level of achievement known as a "maximum" award. To merit this award, Service or Business Plan targets must be far exceeded. There should be a 10 - 20% chance of this level being achieving.