

**MARINE ATLANTIC INC.
SPECIAL EXAMINATION REPORT**

**Presented to the
BOARD OF DIRECTORS
10 September 2004**

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To: The Board of Directors of Marine Atlantic Inc.

I – SPECIAL EXAMINATION OPINION

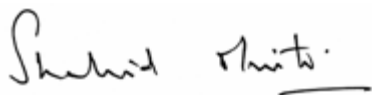
1. Under Part X of the *Financial Administration Act* (FAA), Marine Atlantic Inc. is required to maintain financial and management control and information systems and management practices that provide reasonable assurance that its assets are safeguarded and controlled; its financial, human, and physical resources are managed economically and efficiently; and its operations are carried out effectively.
2. The FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every five years.
3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination, from 18 August 2003 to 31 March 2004, there were no significant deficiencies in the systems and practices examined.
4. We based our examination plan on a survey of the Corporation's systems and practices, which included a risk analysis. We submitted the plan to the Audit Committee of the Board of Directors on 4 December 2003. The plan identified the systems and practices that we considered essential to providing the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources managed economically and efficiently, and its operations carried out effectively. Those are the systems and practices that we selected for examination.
5. The plan also included the criteria that we selected specifically for this examination, in consultation with the Corporation. The criteria were based on our experience with performance auditing. Our choice of criteria was also influenced by legislative and regulatory requirements, professional literature and standards, and practices followed by the Corporation and other organizations. The systems and practices we examined and the criteria we used are listed in Appendix A.
6. We conducted our examination in accordance with our plan and with the standards for assurance engagements established by The Canadian Institute of Chartered Accountants. Accordingly, it included the tests and other procedures we considered necessary in the circumstances. In carrying out the special examination, we relied on the work of the Corporation's internal auditor in the areas of purchasing and overtime.

7. We identified two significant deficiencies:

- **The Corporation does not have reasonable assurance that its operations are efficient and economical. In order to have this assurance, it needs to define performance expectations and put in place performance indicators and targets to measure the extent to which expectations are met. The Corporation also needs to develop and implement plans to accomplish critical aspects of its strategic plan. Two important examples include a long-term plan for collective bargaining and a comprehensive plan for vessel replacement.**
- **Initial annual operating agreements with the Minister of Transport have not reflected the known full cost of providing the contracted service. These agreements do not include service standards, other than the number of sailings scheduled monthly. These deficiencies in the agreements limit their effectiveness as a key accountability mechanism in the delivery of the service and could ultimately impact on long-term plans to improve the efficiency and economy of operations.**

8. In our opinion, except for the significant deficiencies described in the preceding paragraph, based on the criteria established for the special examination, there is reasonable assurance that there were no significant deficiencies in the systems and practices we examined.

9. The rest of this report provides an overview of the Corporation, detailed information on the significant deficiencies noted above, other findings, and recommendations and management's responses.



Shahid Minto, CA
Assistant Auditor General
for the Auditor General of Canada

Halifax, Canada
31 March 2004

II – OVERVIEW OF MARINE ATLANTIC INC.

Meeting Canada's constitutional obligation

10. *The Newfoundland Act – Term 32* (1949) between Canada and the Province of Newfoundland and Labrador provides that "Canada will maintain, in accordance with the traffic offering, a freight and passenger steamship service between North Sydney and Port aux Basques, which, on completion of a motor highway between Corner Brook and Port aux Basques, will include suitable provision for the carriage of motor vehicles."

11. The relationship between Marine Atlantic Inc. and Canada (represented by the Minister of Transport) is defined by a 1987 master agreement. The master agreement sets out the arrangements by which the Corporation provides specified contracted ferry services. Annual operating and capital agreements are established that set out the service to be provided and the financial subsidy that the Corporation requires to provide the contracted service (users pay for only a portion of the cost of the service). Marine Atlantic receives the financial subsidy through annual parliamentary appropriations.

12. Marine Atlantic fulfills Canada's constitutional commitment to provide a year-round passenger and freight ferry service between North Sydney and Port aux Basques. In addition, at the request of the Minister of Transport, the Corporation operates a seasonal summer service between North Sydney and Argentia.

13. The master agreement also calls for the Minister of Transport to annually approve Marine Atlantic's fare and rate tariffs and its sailing schedule.

Historical context

14. Marine Atlantic was established in its current form in 1986, but it has a long history. It began as a steamship service connecting Newfoundland's railway to the Canadian system. In 1949, Canada assumed responsibility for the service through a Crown corporation, Canadian National Railway.

15. The National Marine Policy (1995) had Marine Atlantic terminate its other services in Atlantic Canada or transfer them to other operators, leaving as its sole responsibility the services it currently provides.

16. In addition, the National Marine Policy required the Corporation to operate effectively and to manage resources efficiently and economically. The federal government's Program Review in 1995 emphasized providing affordable services and keeping a cap on costs. It did this by setting limits on the government funding (the funding reference level) made available to the Corporation.

17. Historically, these ferry services have been heavily subsidized by government. While they were not designated an essential service in the past, the constitutional commitment and economic imperatives required that the service be maintained.

18. Past special examination reports have raised concerns about the Corporation's operational efficiency and economy. Many observations in the 1999 special examination report dealt with areas that were subject to existing collective agreements. The collective agreements that now govern Marine Atlantic's operation were originally negotiated in a more diverse, geographically larger, and operationally more complex environment.

Legislative mandate

19. The *Marine Atlantic Inc. Acquisition Authorization Act (1986)* established Marine Atlantic Inc. as a parent Crown corporation with a mandate for the

... acquisition, establishment, management and operation of a marine transportation service, a marine maintenance repair and refit service, a marine construction business and any service or business related thereto.

Objectives

20. To fulfill its mandate, the Corporation set out the following objective in its Corporate Plan Summary:

To continue to provide a year-round service between Port aux Basques, NL and North Sydney, NS and a seasonal service between Argentia, NL and North Sydney, NS.

Mission

21. The Corporation states its mission as the following:

To provide our customers with a safe, environmentally responsible and quality Newfoundland-mainland ferry service in a reliable, courteous and cost-effective manner.

Marine Atlantic's operations

22. Marine Atlantic delivers its contracted service using three roll-on, roll-off passenger/freight ferries and a roll-on, roll-off freight ferry. It operates terminal facilities year-round in North Sydney and Port aux Basques and a seasonal terminal in Argentia. The North Sydney terminal has two loading docks; each of the other facilities has one. Fuel storage and blending facilities are located in Port aux Basques.

23. Shore-based operational and technical operations are largely based in North Sydney. Maintenance and administrative staff are split between North Sydney and Port aux Basques.

Corporate headquarters, where the President, corporate counsel, and internal auditor are located, is in St. John's.

24. In 1999 the Corporation had three vessels and employed the equivalent of 754 full-time staff (calculated by dividing the labour hours actually worked by the standard hours in a work year). In 2003, with four vessels, it had 940 full-time-equivalent staff. Labour costs in 2003 represented 58 percent of the Corporation's cash operating expenses.

25. Marine Atlantic operates in a highly unionized environment: five unions represent all non-management positions, the vast majority of the Corporation's employees. A sixth union is currently organizing certain non-union managers.

26. Commercial traffic is steady, with only minor variations in seasonal traffic patterns (for example, slightly higher in spring, summer, and pre-Christmas periods). Passenger traffic is highly seasonal—about 70 percent of the total occurs in June through September.

27. Appendix B provides additional financial and operational data which is presented on the Corporation's fiscal year of 31 December.

Funding issues

28. Marine Atlantic's recent corporate plan summaries have identified repeated shortfalls in funding. The subsidy the Corporation requires each year in order to provide the contracted level of service is more than the funding that the government provides initially. Ultimately, however, Marine Atlantic has received the funding it needs to deliver the contracted service.

29. Despite the funding limitations imposed by the government's 1995 Program Review, the federal subsidy for the Corporation's operational costs has grown 156 percent, from \$16.1 million in 1999, when there were three vessels, to \$41 million in 2003, with four vessels. In the same period, operating costs increased 49 percent while revenues increased 22 percent.

30. The gap between the initially approved government funding for Marine Atlantic and the subsidy needed to provide the contracted service is growing. Appendix C provides a summary of the funding gap from 2001-02 to 2004-05 which is presented on the government's fiscal year-end of 31 March.

Causes of the growing need for funding

31. There are several reasons for the escalating pressures on funding. Comparing 2003 to 1999, the Corporation has spent an additional \$12.4 million operating and maintaining the fourth vessel (not including fuel costs), \$8 million in fuel costs for all its vessels, and \$4.3 million maintaining its three other vessels. Pension and workers compensation contributions are projected to be \$15 million (\$3.5 million in 2003-04) and \$4.5 million (nil in 2003-04) respectively in 2004-05 and are major reasons for the escalating funding requirements.

32. As part of the financing arrangements when the government approved the purchase, it lowered the funding reference level for Marine Atlantic by \$9.940 million a year for nine years with a final amount of \$12 million in the tenth year.

33. The addition of a fourth vessel has had the largest impact on costs. In the rationale for the acquisition of the fourth vessel, Marine Atlantic and Transport Canada indicated that the costs would be offset by operational efficiencies and regular fee increases. Adding a fourth vessel to the Corporation's fleet would enable it to provide more reliable service and meet projected future demand.

34. Marine Atlantic has stated that its budgeting for much of the new vessel's operating and maintenance costs was unrealistic. Most of the employees added between 2000 and 2003 were needed to operate the fourth vessel. At the same time, the growth in traffic that was forecast has not been realized.

An essential service

35. In August 2002, one of Marine Atlantic's unions applied to the Canada Industrial Relations Board to determine whether there was "any question with respect to the application of the Canada Labour Code subsection 87.4(1)." This section of the Code provides the Board with the authority to ensure that essential services or operations are maintained in certain strike or lockout situations.

36. In November 2003, the Board ruled that there was to be "no reduction in the level of Marine Atlantic's regular ferry service between Newfoundland and Nova Scotia at any time of the year." The ruling highlighted the risk to public safety and health should the service be reduced. It effectively prevents Marine Atlantic's unions from conducting legal work stoppages.

III – SIGNIFICANT DEFICIENCIES

37. A significant deficiency exists where a failure to satisfy one or more of the examination criteria prevents, or puts at material risk, the achievement of one or more of the statutory control objectives (assets safeguarded and controlled; resources managed economically and efficiently; and operations carried out effectively).

38. Our special examination of Marine Atlantic identified a significant deficiency in two areas:

- efficiency and economy of operations, and
- annual operating agreements.

Efficiency and economy of operations

39. The Corporation does not have reasonable assurance that its operations are efficient and economical. In order to have this assurance, it needs to define performance expectations and put in place performance indicators and targets to measure the extent to which expectations are met. The Corporation also needs to develop and implement plans to

accomplish critical aspects of its strategic plan. Two important examples include a long-term plan for collective bargaining and a comprehensive plan for vessel replacement.

40. On the subject of operating efficiency, the 2002 strategic plan noted:

Following the most recent [Special Examination] report tabled in the fall of 1999, MAI took the position that priority would first be given to dealing with the capacity and service level issues. This task has largely been completed; attention must now be focused to these efficiency issues.

41. Since the 1999 special examination, the Corporation has placed more emphasis on the reliability and safety of its service. It added a fourth passenger/freight ferry to provide additional capacity for peak summer periods and a backup should its other vessels have mechanical problems. The government and the Corporation invested in the additional vessel so that passengers and commercial traffic could rely on the service. The Corporation also invested in new evacuation systems and additional training for its crews in response to concerns expressed by regulators.

42. The sections that follow describe the Corporation's strategic planning efforts and observations related, in particular, to the human resources issues associated with operating a ferry service in a highly unionized environment. The final sections deal with capital matters related to vessel replacement and shore-based assets. It is the cumulative impact of these observations that led us to conclude that the Corporation does not have reasonable assurance that its operations are efficient and economical.

43. **Developing a strategic plan.** The 1999 special examination report observed that the Corporation did not have a strategic plan to set direction and guide its operations. It began developing such a plan in 2001, led by the former Chairman and President, who obtained input from Board members through informal discussions outside the regular Board meetings.

44. In March 2002, management sent a draft strategic plan to the Board, which approved the plan in June 2002. The strategic plan included an assessment of external threats and opportunities and an assessment of internal strengths and weaknesses. It set out the Corporation's vision, mission, values, and ferry service objective. It also set out goals in the areas of safety, the environment, cost effectiveness, and human resources. Strategies were identified for each of these areas as well as corporate performance measures with proposed targets.

45. While the Corporation indicated that it would review and update the strategic plan annually, it has not done so. Its subsequent corporate plans have stated that action plans would be developed to guide the implementation of the strategies; the Corporation has not yet developed these action plans.

46. Management has informed us that a new strategic planning process began at the end of the special examination period and that the Board will be actively involved in the process.

47. **Need for performance measures.** The Corporation is still refining the performance measures and targets included in the strategic plan. In September 2003, after reviewing the first quarterly report on performance measures, the Board's corporate governance committee asked management to re-evaluate the performance measures. No subsequent quarterly reports have been produced and the Board has yet to formally accept the performance measures and targets.

48. Although the strategic plan contains a form of risk assessment, it is difficult to relate the identified risks to the proposed strategies. Further, the risk assessment was a one-time exercise; the Corporation has no formal, ongoing process for managing risk. Good governance practice would provide Board members with a clear identification of the key risks facing the Corporation, their potential impact, and strategies to manage the risks.

49. The Corporation is in the process of identifying performance measures and targets that will reflect the expected level of service. This initiative is vital to defining the Corporation's expectations for cost-effective operations.

50. **Defining the level of service.** The *Constitution Act* requires Canada to maintain a freight and passenger service between North Sydney and Port aux Basques. The mission statement states that the Corporation will provide passengers with a safe, environmentally responsible, good-quality (reliable and courteous) and cost-effective service. Further clarification that these are elements of the expected service level is provided in the strategic plan's statements of values and operational goals. However, it is not easy to determine the concrete, measurable outcomes expected for each of these elements. (Nor do the annual operating agreements with the Minister of Transport clearly define the level of service the Corporation is to provide (paragraph 82)).

51. The achievement of results in one service area may negatively impact another. For example, while the Corporation's decision to use blended fuel has resulted in significant savings on fuel costs, the use of blended fuel results in a higher level of discharge into the environment. This acts against the Corporation's objective of environmental responsibility.

52. As already noted, the addition of a fourth vessel helped make the service more reliable, but it required a larger operating subsidy from the government.

53. **Vessel operations.** The development of the annual sailing schedule is a key aspect of the Corporation's annual planning process. It is a critical step in matching planned service to customer needs, and it impacts on the cost of the service.

54. Management informed us that the sailing schedule is developed to meet customer needs using input from stakeholder groups. We were told that in order to meet these needs there are times when the scheduling of vessel departures and arrivals may conflict and result in higher costs and lower quality service related to passenger delays.

55. Our analysis of a representative week during the 2003 peak summer season confirmed that a number of schedule conflicts affected the on-time performance of the vessels (at 61 percent in 2003), resulted in additional costs, and required extra management attention. Most of the additional costs were for overtime when vessels arrived or departed off schedule and outside regularly scheduled hours of work.

56. We performed the same analysis for the same week of the 2004 planned schedule with similar results.

57. The 1999 special examination report identified opportunities to improve the turnaround time of vessels in port. During the peak summer season, it takes more than an hour to unload a vessel and reload it for the return trip. In past years, this turnaround time was as low as 40 minutes. Goals for key components of turnaround time have still not been set (such as the time it takes to lower the ramp, to get the first vehicle off, to get the last vehicle off, to load the first vehicle for the next trip, etc.).

58. The Corporation develops the annual sailing schedule based on forecast traffic. Additional sailings are planned but not included in the official schedule. They can be added at management's discretion should actual traffic demand it.

59. Management has informed us that it is working with the trucking industry on initiatives to increase the efficiency and quality of service provided to that industry.

60. **Managing human resources.** Wages and benefits are the Corporation's single largest cost, at \$64.3 million for the year ended 31 December 2003. The Corporation's ability to efficiently match its human resources to its operational needs has been a long-standing concern.

61. Given the importance of the Corporation's human resources to its operations, we expected to find a human resources plan with strategies directly linked to the corporate strategic plan. Management has developed a competency model for management and is developing a succession plan. However, a complete and documented human resources plan is not yet in place.

62. The human resources plan should specifically address issues such as management's preliminary planning for a new ferry in 2006-07. The Corporation's most significant cost in the life cycle of its vessels is the cost of regular crewing. Therefore, it is important that input from human resources management be formally incorporated in planning for vessel acquisition.

63. **Vessel crewing.** Marine Atlantic crews its vessels using standard crewing models for operating status and anticipated passenger levels. A vessel's crew level depends on whether the vessel will be operating, on standby, laid up, or in maintenance. The operational crewing level can also vary depending on the seasonally forecast level of traffic but does not vary with short-term fluctuations in traffic. The standard crewing models have remained the same since the last special examination in 1999.

64. Operating certificates issued by Transport Canada provide for the minimum number of crew required to operate the vessel evacuation systems. Throughout the year, the Corporation's passenger/freight ferries operate with crew levels in excess of those required under its operating certificates. During the peak traffic period, the Corporation may employ crews 40 percent higher than the operating certificate requirements. For example, the MV Caribou normally operates with a crew of 106 during the peak traffic period while its operating certificate only requires a crew of 77. Management has informed us that these crew levels are required for safety and customer service purposes.

65. It is management's responsibility to deploy additional crew where it identifies specific safety responsibilities beyond those associated with the evacuation systems. An examination of the vessel muster list (which sets out crew responsibilities for vessel safety) found that the additional crew are assigned specific safety duties as required.

66. Management informed us that it must anticipate peak passenger demand when it sets crew levels—for example, passenger traffic is higher on weekends, even during the off season.

Management indicated that given the large geographical area where employees live and the restrictive nature of the collective agreements, it is not possible to have employees report on a short-term basis.

67. The staffing levels are based on anticipated numbers of passengers over a period of several months and can be adjusted only with difficulty in the short term. Crew levels can be increased with relative ease, but reducing them below the historical base level could trigger the income security component of the collective agreements, with its associated costs. The income security agreement provides the Corporation's employees with income protection when their jobs are lost due to technological, operational, or organizational change.

68. We were informed that crew levels are generally consistent with past practice and are maintained in accordance with the applicable collective agreements. However, because the Corporation has not developed specific standards for employee productivity and customer service, we were not able to determine whether the crew levels are set at the most cost-effective levels.

69. **Staffing shore-based facilities.** During the examination, we observed opportunities to increase the efficiency of staffing for the Corporation's shore-based facilities. For example, stevedore wages, including overtime, are significantly higher in North Sydney than in Port aux Basques, even though both facilities support similar operations. The main difference is that the Port aux Basques stevedores work split shifts, which better match the Corporation's operational needs.

70. **Impact of collective agreements.** The Corporation's collective agreements, which it has entered into with its five unions, are complex and not always responsive to the Corporation's operational requirements. The agreements are restrictive in key areas that are critical to efficient operations, such as the filling of vacant positions, replacement of workers during absences, scheduling, and overtime.

71. Managers are not provided with adequate training on how to manage in a heavily unionized environment with a special focus on the Corporation's collective agreements. In one case, for example, part-time employees working under a temporary arrangement became permanent even though their services were no longer required. These positions will now be considered a part of the minimum crew. Elimination of the positions would likely trigger the income security component of the collective agreement.

72. Marine Atlantic does not have a long-term strategy to renegotiate restrictive provisions of its collective agreements. Such a strategy would focus on an assessment of the relationship with the unions, designating issues that could be resolved through collective bargaining.

73. **Long-term asset planning.** Marine Atlantic's operations are capital-intensive. It takes considerable time to plan for and acquire vessel and shore-based facilities that match the Corporation's current and future operational needs.

74. The Corporation has been reactive in its planning for future capital needs. For example, two reports on long-term fleet requirements were produced at Transport Canada's request in 2002 and 2003 to deal with the Corporation's shortfall in ongoing funding. The processes supporting these fleet planning reports were not well documented. While the reports present the case for long-term vessel requirements, they do not present a fleet renewal strategy to replace or renew the Corporation's aging vessels. Until this year, corporate plans did not include complete plans for vessel replacement.

75. In general, vessel planning has been reactive, ad hoc, and poorly documented. Management has informed us that vessel planning is an ongoing process and those involved have an intimate knowledge of the planning issues. A process is under way to complete assessments of the condition of the MV Caribou and the MV Smallwood in 2004. The results of this work will lead to a comprehensive vessel plan that management expects to include in the 2005 Corporate Plan.

76. To determine its operational needs the Corporation regularly forecasts the short- and long-term traffic demand. For the short term, management applies its collective judgment, incorporating input from stakeholders and limited economic information. For the longer term, it uses methodology that overstates the future traffic demand. We are concerned that overstating future demand could impact on the timing of and approach to vessel planning.

77. The cumulative impact of weaknesses in vessel planning is demonstrated by the changing status of plans for the MV Atlantic Freighter, the Corporation's freight ferry.

Changing Plans for the MV Atlantic Freighter

The MV Atlantic Freighter was built in 1978 and has been the Corporation's lowest-cost vessel for freight service. In 1998, the Corporation proposed that when it purchased a new passenger/freight ferry it would dispose of the MV Atlantic Freighter.

By 1999, the Corporation had decided to keep the MV Atlantic Freighter and, in the 2001-05 Corporate Plan Summary, proposed an \$8 million mid-life refit to be completed in 2003-04.

In a 2002 fleet planning document, the Corporation indicated that the MV Atlantic Freighter would be retired in 2006. The fleet plan for 2003 reconsidered the retirement of the MV Atlantic Freighter, based on an assessment of the vessel's condition and its ability to handle certain kinds of freight.

The 2003-07 Corporate Plan Summary, approved by the Treasury Board in December 2002, indicated that the MV Atlantic Freighter would undergo a \$4.7 million refit beginning in December 2002. This refit was carried out in January 2003.

Currently the Corporation is proposing additional work on the MV Atlantic Freighter by 2006, at an estimated cost of over \$1 million. This would allow the vessel to operate until at least 2008.

78. The purchase of the fourth vessel, the MV Leif Ericson, also shows the potential impact of shortcomings in vessel planning. The decision to purchase was made quickly, in response to negative reactions of customers and stakeholder groups to problems of service reliability in 1998 and 1999.

79. Originally, the new vessel was going to serve the Argentia seasonal route. However, the vessel chosen, the MV Leif Ericson was not fast enough and did not provide sufficient accommodations for this route.

80. Management has indicated that the vessel does not perform well in sea ice conditions, limiting its usefulness in winter. Keeping the vessel on schedule has been difficult because of its speed limitations. This has had an impact on expenses for crew and shore-based labour and overtime.

81. **Shore-based assets.** The Corporation only recently began to formally assess its shore-based facilities. In January 2004, the President requested an assessment of the condition of all shore-based facilities. We have been informed that this assessment will be used in the 2005 planning process.

Annual operating agreements

82. **Initial annual operating agreements with the Minister of Transport have not reflected the known full cost of providing the contracted service. The agreements do not include service standards, other than the number of sailings scheduled monthly. These deficiencies in the**

agreements limit their effectiveness as a key accountability mechanism in the delivery of the service and could ultimately impact on long-term plans to improve the efficiency and economy of operations.

83. The overview of Marine Atlantic (page 3) provides a detailed description of the relationship and arrangements between Canada (represented by the Minister of Transport) and Marine Atlantic. Their annual operating agreement is an important accountability mechanism governing this relationship.

84. The need for a federal subsidy has increased significantly since a fourth ferry was introduced in the summer of 2000. However, funding reference levels have not increased accordingly and Transport Canada's Main Estimates do not inform Parliament of the full subsidy required.

85. **Budget preparation.** The Corporation annually forecasts the next year's traffic and develops a sailing schedule to meet the projected demand. The Corporation prepares a budget based on the schedule; it also proposes the fare and rate tariff for the upcoming year. Transport Canada officials review this information on behalf of the Minister of Transport.

86. If the Minister of Transport agrees with Marine Atlantic's proposals, the Corporation is formally notified. In addition, annual operating and capital agreements are established that set out the scheduled services and the subsidy required to provide them. The Corporation then incorporates this information into its corporate plan and its operating and capital budgets, which it submits to the Treasury Board and the Governor-in-Council for approval.

87. Since 2001-02, the corporate plan has included an estimate of the needed operating subsidy that has been significantly higher than the original amounts in the initial operating agreements with the Minister of Transport. As the government identified the source and amount of additional funding, the operating agreements have been amended.

88. For example, Marine Atlantic's 2003-04 Corporate Plan Summary indicated that the Corporation would require a \$47 million operating subsidy for that year. That document was approved by the Treasury Board in December 2002. The operating agreement with the Minister of Transport for 2003-04 was dated March 2003 and initially provided for an operating subsidy of only \$18.8 million—which represented the operating portion of the capped overall funding to Marine Atlantic for the fiscal year. The Corporation was to receive \$15.4 million of that amount by 31 December 2003.

89. This agreement was amended in June 2003 to provide the Corporation with the full \$18.8 million by 31 December 2003. In October 2003, the agreement was amended again to provide an additional \$16.5 million by 31 December 2003, bringing the total funding for operations available to Marine Atlantic to \$35.3 million.

90. Marine Atlantic's analysis of cash flow during 2003-04 indicated that the Corporation had to defer or eliminate certain significant expenditures to avoid overspending its cash resources. For example, it delayed a regularly scheduled refit of one of its ferries from the fall of 2003 until after 31 March 2004. This allowed it to defer \$1 million in expenditures until new funding became available. We are concerned that such decisions taken to manage in the short term may compromise long-term plans to improve economy and efficiency.

91. Although we did not observe any direct impacts of the cash flow situation on the safety or reliability of service, the ongoing uncertainty of funding can affect the long-term cost-effectiveness of the service.

IV – OTHER FINDINGS

Quality of service

92. The 1999 special examination report made a number of observations on issues of quality of service. The present examination found that the Corporation has placed considerable emphasis on improving the service it delivers, and its customer surveys indicate a high level of customer satisfaction as a result. The most recent survey, in 2003, found that 97 percent of passengers were satisfied with the service.

93. The low level of on-time performance, noted earlier in this report, is highlighted in the customer survey results. However, the surveys appear to indicate that customers give more importance to the increased reliability of the service, associated largely with the addition of the fourth vessel.

Safe and environmentally responsible service

94. Marine Atlantic places great emphasis on the safety of its operations, for both its customers and its employees.

95. **Systems and procedures.** The Corporation maintains its vessels in accordance with requirements by Transport Canada and classification societies (organizations that establish standards for ships maintenance). It operates its vessels in accordance with the International Management Code for the Safe Operation of Ships and for Pollution Prevention (ISM Code). The Corporation's vessels maintained their Transport Canada operating certificates throughout the period under examination.

96. Before and during our special examination, several serious incidents occurred onboard the vessels. Marine Atlantic has adjusted safety procedures and provided training in response to concerns raised in post-incident reviews conducted by the Corporation itself and by the Transportation Safety Board of Canada.

97. It has also implemented some aspects of the Canadian Standards Association Standard S826—Ferry Boarding Facilities. The Standard is not mandatory but represents best practice.

98. The Corporation has not performed a complete threat and risk assessment to determine whether current systems and practices are sufficient to protect vessels and shore-based facilities against all significant risks. This is a concern especially for its terminal operations, which have public access and security issues.

99. Although the Corporation has an information technology back-up plan and various arrangements to deal with potential problems, there is no complete plan for resumption of business in the event of a major service disruption. Such a plan should be available to ensure continuity of service, given that the service is essential.

100. The Corporation does not have a formal environmental management system but does have in place many elements of such a system. Few environmental incidents were noted during the special examination period, and the Corporation responded positively to those in order to reduce the likelihood of future occurrences.

101. The Corporation conducted occupational health and safety reviews during 2003 and determined that a formal corporate occupational safety and health system was needed to incorporate all requirements of the Canada Labour Code. Management believes that many elements of such a system are already in place.

102. Management has begun developing an overarching quality, safety, and environmental management system to integrate all related systems and provide a complete accountability

framework. We were informed that the first step will be the procurement of a shore-side safety system, with further development of an environmental management system to follow.

103. **Training.** The Corporation has invested considerable funds over the past two years in training its employees. Much of this training has safety and environmental applications, which should have a positive effect on the safety and environmental aspects of its operations. However, we have concerns about the Corporation's ongoing management of training. Specifically, it has not completed a comprehensive assessment of the safety, environmental and service competency requirements of each position and ensured that those holding the positions have received the required training.

Governance

104. In recent years, the expectations of the roles and responsibilities and of the performance of boards of directors have increased. We observed that the Marine Atlantic Board of Directors has adopted many good practices and is improving its performance.

105. There are several important areas, however, where the Board has not provided sufficient leadership, including strategic direction, risk management, succession planning, and collective bargaining strategy. The Board has yet to set and monitor the Chief Executive Officer performance expectations, although there are plans to do this in the upcoming year. Board policies and practices are not documented in a governance manual, and the code of conduct and ethics guidelines are not up to date.

106. The Board has plans to be more proactive in the upcoming annual corporate planning process which will also include a more active role for Board members in setting strategic direction. This is important as currently the strategic, corporate and annual plans are not well integrated.

107. Last year, Marine Atlantic Board members undertook corporate governance training. In the upcoming year, they will undertake training in their roles as audit and pension committee members.

V – RECOMMENDATIONS AND MANAGEMENT RESPONSES

108. **Recommendations.** The following are four recommendations related to the significant deficiencies:

109. The Corporation should develop and put in place performance measures and targets that define service expectations and be the basis for accountability to the Board and the government.

Management response. Performance measures and targets have been finalized, approved by the Board and are in place.

110. The Corporation should better align its collective agreements and operating requirements, with a view to improving the efficiency of operations.

Management response. The Corporation is committed to a long-term approach to improving the efficiency of operations, including increased efficiencies in its use of human resources.

111. The Corporation should develop a comprehensive vessel replacement plan based on operating needs and full life-cycle costs.

Management response. The plan has been developed and the first stage is in place.

112. Working in collaboration with Transport Canada, the Corporation should establish annual operating agreements with the Minister of Transport that include both the full cost of providing the contracted service and the planned level of service performance.

Management response. The process has been put in place for 2004 and will continue in the future.

Appendix A

Key Areas Examined and Related Examination Criteria

KEY AREAS	EXAMINATION CRITERIA
<p><u>Safe and Environmentally Responsible Service</u></p> <p>Governance and planning</p> <ul style="list-style-type: none"> ➤ Governance – roles and responsibilities ➤ Strategic and corporate plans ➤ Vessel and shore-based facilities planning <p>Operations – vessels and shore-based facilities</p> <ul style="list-style-type: none"> ➤ Safety monitoring and reporting (ISM code requirements, classification society certification and Transport Canada certification) ➤ Environmental management system ➤ “Class”-based maintenance and refits ➤ Vessel loading and unloading procedures (Canada Standards Association standard) <p>Hospitality services</p> <ul style="list-style-type: none"> ➤ Food services <p>Human resources</p> <ul style="list-style-type: none"> ➤ Officer, crew and staff training and deployment 	<ul style="list-style-type: none"> ➤ Operations should be conducted in a manner that ensures the safety and security of passengers and employees, and safeguards passenger vehicles. ➤ Operations should be conducted in a manner that protects the environment.
<p><u>Quality Service</u></p> <p>Governance and planning</p> <ul style="list-style-type: none"> ➤ Strategic and corporate plans ➤ Performance expectations and reporting ➤ Traffic forecasting and sailing schedules ➤ Agreements with Minister of Transport <p>Hospitality services</p> <ul style="list-style-type: none"> ➤ Stakeholder consultations ➤ Customer satisfaction surveys ➤ Food services ➤ Reservation system ➤ Customer communications – onboard vessels ➤ Customer communications – schedule and sailing information <p>Human resources</p> <ul style="list-style-type: none"> ➤ HR planning ➤ Officer, crew and staff training and deployment ➤ Labour relations 	<ul style="list-style-type: none"> ➤ Customer needs and satisfaction should be known and considered in determining the level of service to be provided. ➤ Vessels, shore-based facilities and personnel should deliver the Corporation’s planned level of customer service.

KEY AREAS	EXAMINATION CRITERIA
<p>Operations – vessels and shore-based facilities</p> <ul style="list-style-type: none"> ➤ Cleaning/maintenance of vessels and shore-based facilities ➤ Discretionary sailing process 	
<p>Cost-effective Service</p> <p>Governance and planning</p> <ul style="list-style-type: none"> ➤ Governance and the Board of Directors ➤ Governance – pension management ➤ Internal audit ➤ Strategic and corporate plans ➤ Performance expectations and reporting ➤ Traffic forecasting and sailing schedules ➤ Agreements with the Minister of Transport ➤ Operational planning and budgeting ➤ Rate proposal development ➤ Vessel and shore-based facilities planning <p>Human resources</p> <ul style="list-style-type: none"> ➤ HR planning ➤ Collective bargaining ➤ Officer, crew and staff training and deployment <p>Operations – vessels and shore-based facilities</p> <ul style="list-style-type: none"> ➤ “Class”-based maintenance and refits ➤ Vessel loading and unloading procedures (Canada Standards Association standard) ➤ Discretionary sailing process ➤ Purchasing and materiel management (including major capital purchases) ➤ Management information and reporting 	<ul style="list-style-type: none"> ➤ The mandate and mission should be consistent with the underlying legislative authority and agreements with the Minister of Transport. ➤ The Corporation should have key corporate strategies and clear objectives to ensure that the mandate and mission, and commitments made under agreements with the Minister of Transport are delivered in a cost-effective manner. ➤ Key corporate strategies should be known to the shareholder and should be committed and support the combination of vessel schedules, rates, operating and capital funding necessary to provide a cost-effective service. ➤ Plans that identify and analyze significant operating, business and environmental risks should be in place to ensure proper strategies are implemented. ➤ Performance expectations should exist for the key expected corporate results. ➤ Costs and performance should be known and used to support management decision-making and accountability with the shareholder. ➤ Rates and other revenues should be determined in a manner that supports the delivery of a cost-effective service. ➤ Acquisition, utilization and maintenance strategies for vessels and shore-based facilities should meet current and future operating needs and be based on the lowest full life-cycle cost. ➤ Staffing levels and skills should meet current and future operating needs in a cost-effective manner.

Appendix B
Marine Atlantic Inc.
Key Financial and Operational Data
for the years ended December 31

	1999	2000	2001	2002	2003	% change between 2003 & 1999
<u>Financial Data (\$000)</u>						
Revenue	52,337	59,974	60,783	64,843	64,032	22%↑
Cost of operations	88,881	106,776	116,922	127,322	132,566	49%↑
Government of Canada funding of operations	16,113	25,440	32,403	36,660	40,962	156%↑
<u>Operational Data</u>						
Passengers	477,761	508,970	481,560	528,975	457,229	4%↓
Passenger vehicles	149,732	159,759	153,880	172,728	151,188	1%↑
Commercial vehicles	76,905	77,289	78,963	79,092	81,169	6%↑
Number of single crossings	1,796	2,238	2,175	2,230	2,096	17%↑
Number of vessels	3	4	4	4	4	33%↑

Note: This appendix is completed on the basis of Marine Atlantic Inc.'s 31 December year end.

**Appendix C
Marine Atlantic Inc. Funding Gap
(\$ millions)**

Year Ended March 31	Marine Atlantic Inc. Corporate Plan (Operating subsidy required)	Main Estimates	Initial Funding Gap	Supplementary Estimates and Transfers	Total Government Funding
2002	44.993 (31.306)	36.347	8.646	0.437	36.784
2003	36.176 (30.619)	32.949	3.227	13.432	46.381
2004	51.559 (46.918)	25.095	26.464	16.500	41.595
2005	72.857 (60,615)	27.607	45.250	N/A	27.607

N/A – not applicable

Note: This appendix has been completed on the basis of the government's fiscal year end of 31 March and includes all funding provided to the Corporation (that is, operating, capital and restructuring). The operating subsidy required is shown in brackets.