Canada Post Corporation

Special Examination Report—2009

Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

KPMG

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Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

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26 November 2009

To the Board of Directors of Canada Post Corporation

We have completed the special examination of Canada Post Corporation in accordance with the plan presented to the Audit Committee of the Board of Directors on 3 December 2008. As required by Section 139 of the *Financial Administration Act* (FAA), we are pleased to provide the attached final special examination report to the Board of Directors.

Pursuant to Section 140 of the FAA, it is our opinion that this report contains information that should be brought to the attention of the Minister of Transport, Infrastructure and Communities. Accordingly, following consultation with the Board, we will be forwarding a copy of the report to the Minister.

We will be pleased to respond to any comments or questions you may have concerning our report at your meeting on 3 December 2009.

We would like to take this opportunity to express our appreciation to the Board members, management, and the Corporation's staff for the excellent cooperation and assistance offered to us during the examination.

Yours sincerely,

Nancy Y Cheng, FCA
Assistant Auditor General

Barry J. Lalonde, CA
Partner, KPMG LLP

Attach.

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Main Points

What we examined

Canada Post Corporation is one of the largest federal Crown corporations and one of the largest employers in Canada, with about 60,000 full- and part-time employees (its subsidiaries employ about another 12,000 people), most of whom are unionized. In 2008, the Corporation earned $6.1 billion in revenues, which is 79 percent of consolidated revenue from operations; its earnings before taxes were $66 million. A Crown corporation since 1981, Canada Post reports to Parliament through the Minister of Transport, Infrastructure and Communities.

As Canada's national postal service, Canada Post Corporation is expected to provide a standard of service that will meet the needs of Canadians and that is similar with respect to communities of the same size. It is also expected to be financially self-sustaining.

We examined Canada Post Corporation's systems and practices to determine whether, in the period under examination, they provide the Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

We examined, among other things, the postal transformation initiative, corporate governance, strategic planning, performance measurement and reporting, and human resources management. The postal transformation initiative is an estimated $3.1 billion project to replace outdated postal facilities and transform operational processes that Canada Post developed in response to the critical issue of its aging infrastructure. The project is the centrepiece of the Corporation's strategy to reduce long-term costs, improve workplace safety, increase productivity, provide the base for new products and services, and achieve a sustainable environment. Canada Post has said that the initiative's successful implementation is essential to the Corporation's survival and future financial sustainability.

Our examination covered the systems and practices that were in place between February 2008 and May 2009. We extended our examination period to August 2009 to consider events related to the postal transformation initiative. We did not examine the systems and practices of the Corporation's subsidiaries (such as Purolator Courier Ltd.), which are not wholly owned and therefore are not included in the special examination requirements of the *Financial Administration Act*.

Why it's important

Canadians rely on the services provided by Canada Post and expect prompt, reliable mail delivery to their door or a conveniently located postal box at fair and reasonable prices. In addition to providing this universal postal service, the federal government requires Canada Post to provide various services aimed at achieving other public policy objectives—for example, maintaining rural mailbox delivery and respecting the moratorium on the closing of rural post offices, providing free mail for material for the blind and for parliamentarians, and discounting postal rates for library books. While the government provides some compensation for added costs or lost revenue as a result of such services, these requirements limit the Corporation's flexibility for cutting costs and meeting its commercial objectives.

Like other large postal services around the world, Canada Post Corporation must respond to the challenges of an aging infrastructure and workforce. In addition, it faces growing competition for its traditional markets from other delivery services and electronic mail. In these circumstances, it is crucial that it have in place well-designed and well-functioning systems and practices to enable it to face these challenges to its survival.

What we found

Our examination found a significant deficiency relating to a strategic risk due to lack of funding for the postal transformation initiative.

- The Corporation has not yet secured the funding it needs to complete the crucial planned $ 3.1 billion postal transformation initiative. Due to funding pressures increased by the downturn in the Canadian economy, such as those from the decline in postal volumes and the possibility of significant payments to its pension fund, it has been unable to fund the initiative internally to 2010, as originally planned. As a result, the timeline and the period to realize benefits have been extended considerably. The changes in the planned rollout of the transformation impact virtually all aspects of the organization, putting at risk the future sustainability of the Corporation's operations and its ability to fulfill its mandate for universal mail service.

  Subsequent to our examination, in June 2009, Canada Post informed us that the government reacted positively to its proposal to increase postal rates and the Corporation's borrowing limit. This may provide the funding that would allow the Corporation to complete its original plan. However, at the time of our examination, it was too early to determine what impact this would have on the Corporation's financial sustainability and its ability to fulfill its mandate in the long term.

We found several areas with good practices.

- The Corporation has good systems and practices to manage the postal transformation initiative. The Board of Directors has been involved in oversight and approval of decisions relating to planning and implementing this initiative. Management has established good project management practices to monitor the initiative as it is implemented.
- Generally we found good systems and practices for human resource management, an important function in this large corporation of close to 60,000 employees.
- The Board of Directors has access to the resources it needs to discharge its responsibilities for stewardship and oversight of the Corporation as well as the subsidiaries, and it exercises those responsibilities.

We also identified some areas requiring improvement.

- The Corporation places more emphasis on financial objectives and targets than on other aspects of performance, and in activities outside the postal transformation initiative, it focuses on annual targets rather than the long-term horizon and alignment with strategic direction. In addition, while Canada Post has established delivery standards for its universal service obligation, it has few performance indicators for its other public policy objectives.
- In planning its future needs, the Corporation does not validate the cost estimates prepared by facilities management contractors for repairs and maintenance of its buildings until it enters into contracts. Nor does it consistently manage its aging capital assets on a life cycle basis. However, changes are planned that will provide for collecting the necessary data to support life cycle management systems, which management needs for the estimated $2.4 billion in major capital assets the Corporation plans to purchase under the postal transformation initiative.
- The terms and conditions of contracts with its related companies may not protect the interests of Canada Post.

The Corporation has responded. *Canada Post Corporation agrees with the recommendations. Its responses follow the recommendations throughout the report.*

Special Examination Opinion

To the Board of Directors of Canada Post Corporation

1. Under section 131 of the *Financial Administration Act* (FAA), the Canada Post Corporation 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. Section 138 of the FAA also requires the Corporation to have a special examination of these systems and practices carried out at least once every 10 years.

3. Our responsibility is to express an opinion on whether there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices. The examination period was from February 2008 to May 2009, except for the events referred to in paragraph 7 below, for which the examination period was extended to August 2009.

4. We based our examination plan on our survey of the Corporation's systems and practices and a risk analysis. On 3 December 2008, we submitted the plan to the Audit Committee of the Board of Directors. 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 examination plan also included the criteria that we used to examine the Corporation's systems and practices. These criteria were selected for this examination in consultation with the Corporation. The criteria were based on our experience with performance auditing and our knowledge of the subject matter. The criteria and the systems and practices we examined are listed in **About the Special Examination** at the end of this report.

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 Internal Audit on the Corporate Team Incentive program.

7. We noted a significant deficiency relating to a strategic risk due to lack of funding for the postal transformation initiative. The Corporation has not yet secured the funding it needs to complete the crucial planned $3.1 billion postal transformation initiative. Due to funding pressures increased by the downturn in the Canadian economy, such as those from the decline in postal volumes and the possibility of significant payments to its pension fund, it has been unable to fund the initiative internally to 2010, as originally planned. As a result, the timeline and the period to realize benefits have been extended considerably. The changes in the planned rollout of the transformation impact virtually all aspects of the organization, putting at risk the future sustainability of the Corporation's operations and its ability to fulfill its mandate for universal mail service. Subsequent to our examination, in June 2009, Canada Post informed us that the government reacted positively to its proposal to increase postal rates and the Corporation's borrowing limit. This may provide funding that would allow the Corporation to complete its original plan. However, at the time of our examination, it was too early to determine what impact this would have on the Corporation's financial sustainability and its ability to fulfill its mandate in the long term.

8. In our opinion, based on the criteria established for the examination, there is reasonable assurance that during the period covered by the examination there were no significant deficiencies in the Corporation's systems and practices, except for the significant deficiency described in paragraph 7 above.

9. The rest of this report provides an overview of the Corporation and more detailed information on our examination observations and recommendations.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

KPMG LLP

KPMG LLP
Chartered Accountants,
Licensed Public Accountants

Ottawa, Canada
15 May 2009, except for paragraph 7 above,
which is as of 10 August 2009

Overview of Canada Post Corporation

10. Canada Post Corporation (Canada Post or the Corporation) operates Canada's national postal service. As outlined in the *Canada Post Corporation Act*, Canada Post is expected to provide a standard of secure postal service, at a fair and reasonable price, that meets the needs of Canadians and is similar with respect to communities of the same size. This is often described as the Corporation's universal service obligation. Canada Post Corporation is also expected to operate on a self-sustaining financial basis. As a Crown corporation listed in Schedule III, Part II of the *Financial Administration Act* (FAA), the Corporation does not depend on appropriations for operating purposes. It is expected to earn a return on equity and to pay dividends to the federal government. Canada Post reports to Parliament through the Minister of Transport, Infrastructure and Communities (the Minister of Transport), who represents the federal government as the shareholder of the Corporation. In 2008, a Minister of State (Transport) was appointed to assist the Minister in carrying out his responsibilities, including those related to Canada Post.

11. Canada Post has three primary lines of business. Transaction Mail includes bills, statements, invoices, payments and other letters, which it delivers in paper and electronic format. The Corporation's Parcels line of business provides shipping and delivery services. Canada Post's Direct Marketing business includes its Addressed Admail™ and Unaddressed Admail™ services. Other business units provide support and administrative services, including strategy setting and planning, marketing and sales, human resources, finance and procurement, government relations, communications, corporate social responsibility, internal audit, and operation of the postal network. Exhibit 1 illustrates Canada Post's financial performance over the past five years.

12. The Canada Post Group includes Canada Post and its subsidiaries—Purolator Courier Ltd. and SCI Group Inc. The Canada Post Group also includes Innovapost Inc., a joint venture that Canada Post and CGI Group Inc. own. The subsidiaries and joint venture are not wholly owned and are excluded from the scope of this special examination.

Exhibit 1 Summary of Canada Post's (unconsolidated) financial performance

Key financial information ($ millions)	2008	2007	2006	2005	2004
Revenue from operations					
Transaction Mail	3,234	3,214	3,207	3,107	3,051
Parcels	1,311	1,239	1,195	1,170	1,064
Direct Marketing	1,431	1,391	1,298	1,182	1,124
Other Revenue	132	111	131	128	143
Total revenue from operations	6,108	5,955	5,831	5,587	5,382
Income before income tax	66	78	99	250	197
Assets	5,096	4,734	4,617	4,387	4,306
Acquisition of capital assets	271	238	227	143	195

Source: Canada Post annual reports

Public policy objectives

13. In addition to providing a universal postal service, the Corporation is required to provide various services aimed at achieving other public policy objectives. For example, under the *Canada Post Corporation Act*, Canada Post provides free postal service for parliamentarians and certain senior government officials and for materials for the blind.

14. In 2006, the Corporation received two directives from the government requiring it to continue subsidizing postal rates for Canadian publications until March 2009 and to reinstate mail delivery in certain rural areas. These services result in additional costs or reduced revenues for the Corporation. In some cases, the federal government partially compensates the Corporation for the additional costs or lost revenue.

15. The *Canada Post Corporation Act* also states that postage rates shall be fair and reasonable, as well as sufficient to defray the Corporation's operating costs, when combined with revenue from other sources. In 1998, the federal government established a policy framework that includes performance and financial targets for Canada Post. The government also established a price cap formula for limiting increases in the basic letter rate.

16. In April 2008, the Minister of Transport announced that the federal government would conduct a strategic review to examine Canada Post's public policy objectives, commercial activities, and the continued relevance of its financial and performance targets. An external advisory panel led the review. The panel submitted its report, the Strategic Review of the Canada Post Corporation, to the Minister of State (Transport) in December 2008, who made it public in April 2009.

Operating environment

17. **Declining volume of Lettermail.**™ As Canada Post reported in its 2008 Annual Report, demand for Lettermail™ service, the most profitable part of Canada Post's business, has been declining since 2007. In 2008, the number of pieces of Lettermail™ that Canada Post delivered dropped by about one percent from 2007 levels. The number of addresses to which Canada Post delivers increases by about 200,000 every year (Exhibit 2). The result is that while the cost of delivery increases, revenue per address drops because each household or business is receiving and mailing fewer letters. Canada Post is not alone in this experience. Other postal services around the world are also reporting less demand for postal services. The United States Postal Service (USPS) recently reported substantial drops in revenue and volume. For its fiscal year ending 30 September 2008, USPS reported its total mail revenue was down 0.4 percent from the previous year, but total volume was down 4.5 percent.

18. **Infrastructure.** Canada Post operates the largest retail network in Canada, with 6,600 retail postal outlets in urban, rural, and remote locations. In addition, it operates 21 mail processing plants and 565 depots. Most of Canada Post's mail processing plants are more than 40 years old, and some critical pieces of operating equipment are old and in need of replacement.

Exhibit 2 The volume of Canada Post's transaction mail decreased and service increased

Key Operating Statistics	2008	2007	2006	2005	2004
Transaction Mail delivered volumes (in billions of pieces)	5.21	5.27	5.32	5.30	5.24
Delivery addresses (in millions)	14.7	14.5	14.3	14.1	13.8

Source: Canada Post annual reports

19. **Employees.** Canada Post Corporation is one of the largest federal Crown corporations. With about 60,000 employees, most of them unionized, the Corporation is also one of the largest employers in Canada. Canada Post's workforce is aging. Over the next 5 to 10 years, the workforce faces significant attrition, including the loss of some of its key professionals and managers. The aging workforce also adds to health and safety problems among these employees, such as physical strain and injuries to plant workers.

20. The Corporation provides a defined benefit pension plan for its employees. The pension fund, held by external trusts, was valued at $12 billion at the end of 2008, one of the largest in the country. Both the employees and the Corporation contribute to the fund. Following declines in the stock market, the Corporation resumed making current service contributions to the pension plan in November 2008. These contributions are expected to be $271 million in 2009. Canada Post expects that its corporate contributions could increase significantly by 2010 due to special payments.

Focus of the special examination

21. We examined Canada Post Corporation's systems and practices in the areas of governance; strategic planning and risk management; performance measurement, monitoring, and reporting; human resources management; infrastructure; postal transformation; and customer relationship management. Our objective was to determine whether the Corporation has reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

22. Further details on the audit objective, the key systems and practices examined, and the criteria are provided in **About the Special Examination** at the end of the report.

Observations and Recommendations

The Modern Post

The Corporation has not secured funding for its postal transformation initiative

23. For the past few years, Canada Post has been working toward what it calls the "Modern Post." In 2006, the Corporation reorganized along its three major lines of business:

- transaction mail,
- parcels, and
- direct marketing.

The Corporation identified three main elements to becoming a more efficient and modern postal service:

- engaging employees,
- investing in infrastructure, and
- growing the business.

The Corporation has initiated various employee engagement activities intended to improve job satisfaction, increase awareness of health and safety issues, reduce absenteeism, and improve productivity.

24. The postal transformation initiative is the centrepiece of Canada Post's move toward the Modern Post. This initiative is an estimated $3.1 billion project designed to replace Canada Post's aging infrastructure and to transform its mail delivery processes. The estimated costs for the initiative include about $2.4 billion for capital assets and an additional $700 million for transitional costs, such as training, communication, and project management.

25. Some critical pieces of operating equipment are old and in need of replacement. This aging infrastructure increases health and safety risks for employees and decreases the Corporation's ability to meet service standards, to introduce new products and services to meet competitive pressures, and to improve productivity. Through this investment in infrastructure, Canada Post intends to replace obsolete buildings, equipment, and systems, beginning with its mail processing plant in Winnipeg, which the Corporation says needs urgent attention.

26. The postal transformation initiative is the Corporation's primary strategy to improve its ability to be financially self-sufficient by reducing long-term costs, improving workplace safety, and increasing productivity. The initiative is also part of Canada Post's strategy to increase its competitiveness by providing new processes and computer support for new products and services. Canada Post expects the initiative to help it achieve its environmental goals.

27. The Corporation expects the anticipated retirement of many employees over the next 10 years to create an opportunity to reduce costs. The new systems are expected to improve productivity significantly, and the Corporation anticipates it will not need to replace all of its departing employees. At the outset, management stated that if Canada Post does not successfully implement the transformation initiative, it may not be able to take advantage of this attrition. This could have significant impacts on future sustainability. Accordingly, this initiative needs to be completed to allow the Corporation to manage its resources with due regard for economy, efficiency, and effectiveness. Management has been providing information to the Board about the Modern Post since 2005 and about the postal transformation initiative since 2006.

28. Canada Post has advised the shareholder—the Government of Canada, through the Minister of Transport—of its general intentions, through the corporate planning process. We found the Corporation did not seek specific approval for the postal transformation initiative. Although Canada Post is not required to seek separate approval of large initiatives, it is required to operate on a financially self-sustaining basis. Canada Post has said that the postal transformation initiative is key to its continued financial self-sustainability. In May 2009, at the end of the original period of our audit, the Corporation had not obtained approval for the requested changes to its financial framework for financing the initiative.

29. Management and the Board were aware as early as October 2006 that the estimated cost of this major infrastructure rejuvenation initiative was about $3 billion. They were also aware that the Corporation's future earnings might not support the estimated requirement for additional investments of $300 to $400 million per year, beyond the levels the corporate planning process had identified for ongoing operations.

30. The Board approved the postal transformation initiative in September 2007. In April 2008, Canada Post's financial situation worsened as dramatic changes in the Canadian economy caused declines in volumes across all three lines of business and increased the Corporation's required payments to its pension fund. In May 2008, external consultants engaged by the Corporation reviewed Canada Post's plans to finance the postal transformation initiative using cash on hand, proceeds from the sale of assets, and cash from operations. The review concluded that some form of government intervention or support would be required to fund the initiative. In September 2008, the Corporation publicly acknowledged its need to obtain the government's support on a multi-year funding program and to receive approval for borrowing beyond its current limit of $300 million.

31. In light of the financial situation, in June 2008, the Board supported management's decision to change the postal transformation initiative to a phased approach, based on a revised business case with a high-level analysis of estimated costs and benefits. Management committed to not spending more than the Corporation could afford. Phase 1 includes replacing the Winnipeg mail processing plant only and retrofitting new equipment into existing plant designs, where possible, elsewhere in the country. Upgrades to major facilities in Toronto, Montreal, and Vancouver would follow in subsequent phases, if funding is available. In February 2009, management estimated the cost of Phase 1 would be $750 million.

32. A major expected benefit from the postal transformation initiative involves saving money throughout the delivery process because the new automated equipment will reduce the amount of mail sorted by hand. At the end of the original period of our audit, Canada Post had not completed a detailed analysis of the costs and benefits of conducting the postal transformation initiative in phases. Management has prepared an analysis of the expected benefits attrition will provide in Phase I. However, the phased approach may delay some of the expected benefits and may cost more than the original plan. In addition, other considerations make it imperative that Phase 1 be completed by 2010 as it presents a window of opportunity for Canada Post to implement significant operational improvements.

33. In addition to other matters, the Strategic Review panel recommended that the government approve increased financing and access to capital for Canada Post. Subsequent to our examination, in June 2009, Canada Post informed us that the government reacted positively to its proposal to increase postal rates and the Corporation's borrowing limit. This may provide the funding that would allow the Corporation to complete its original plan. However, at the time of our examination, it was too early to determine what impact this would have on the Corporation's financial sustainability and its ability to fulfill its mandate in the long term.

34. **Conclusion on the Modern Post**. As outlined in our opinion, our examination found a significant deficiency relating to a strategic risk due to lack of funding for the postal transformation initiative. The Corporation has not yet secured the funding it needs to complete the crucial planned $3.1 billion postal transformation initiative. Due to funding pressures increased by the downturn in the Canadian economy, such as those from the decline in postal volumes and the possibility of significant payments to its pension fund, it has been unable to fund the initiative internally to 2010, as originally planned. As a result, the timeline and the period to realize benefits have been extended considerably. The changes in the planned rollout of the transformation impact virtually all aspects of the organization, putting at risk the future sustainability of the Corporation's operations and its ability to fulfill its mandate for universal mail service.

35. **Recommendation.** Canada Post should follow up with the government to secure the funding relief to allow the Corporation to complete its transformation to the Modern Post. Also, it should update the detailed costs and benefits analysis to show the feasibility of the postal transformation initiative and to show the payback, which would be an important step to ensure the Corporation's financial sustainability and allow it to deliver on its mandate in the long term.

The Corporation's response. *Canada Post agrees with the recommendation concerning the need to secure the funding to allow the Corporation to complete its transformation to the Modern Post. The Corporation has been actively discussing this with the government and had indicated its need for government support for the initiative in its 2009–2013 Corporate Plan as well as its 2008 submission to the Strategic Review panel. As noted in this report, Canada Post has recently received positive reaction to the idea of a multi-year pricing strategy and an increased borrowing limit and, in October 2009, received government approval for both of these funding components. The Corporation will continue to work with the government in its pursuit of financial self-sustainability, including support for the transformation initiative.*

In addition, the Corporation is in the process of completing a detailed cost and benefit analysis to confirm the benefits associated with a phased implementation of the postal transformation initiative. As we proceed through each phase of the initiative, we will continue to prioritize our activities based on those components that address our most critical operational needs and that have the highest return on investment. We will also maintain our practice of presenting detailed plans, based on the most up-to-date information available, to the Board for their approval.

Corporate governance

36. Corporate governance refers to the structures, systems, and practices that an organization adopts to monitor its strategic direction and management so that it can carry out its mandate and achieve its objectives. Sound practices in corporate governance are essential to meeting the objectives outlined in Part X of the *Financial Administration Act* as it relates to Crown corporations. The role of the Board of Directors is to provide oversight and stewardship of the Corporation. The Board needs to function effectively to ensure that the Corporation can fulfill all aspects of its mandate.

37. We examined the Corporation's main systems and practices in the areas of Board appointments, Board oversight and stewardship, and corporate compliance. We examined arrangements for oversight of the pension fund and the subsidiaries, as well as Board and senior management practices to promote effective shareholder relations. We expected that Canada Post would have a well-functioning corporate governance framework with respect to Board stewardship, including balancing its public policy and commercial objectives, managing its subsidiaries, and complying with laws and regulations, to maximize its effectiveness and achieve its mandate. We also reviewed information provided to Board members, including orientation material for new members and regular and ad hoc reports provided prior to and during meetings. In addition, we examined documents outlining the governance framework and reviewed minutes from Board and committee meetings.

Relationships with the shareholder have improved

38. **Roles and responsibilities.** The Chair of the Board has been active in building the relationship with the Minister responsible for Canada Post. The frequency of the meetings between the Chair and the Minister has increased since November 2008. The procedures for day-to-day communication between Canada Post and Transport Canada are well established. We noted that the views of Canada Post and those of Transport Canada and the central agencies, such as the Treasury Board of Canada Secretariat, differ on the roles and responsibilities for communication among Canada Post and these other parties, the scope of the Board's authority to approve initiatives, and the process for reviewing the Corporate Plan. We found that Canada Post has had mixed success in getting timely approval for the initiatives it has brought to the government. For example, for the past three years, approval of the Corporate Plan has been significantly delayed, beyond the start of the planning period.

39. **Financial framework.** In our view, Canada Post's need to finance the postal transformation initiative, the challenges associated with managing the pension fund, and the risks to the Corporation's ability to sustain itself financially have placed exceptional demands on the Corporation's ability to manage relations with the federal government and to obtain changes to its financial framework. At the start of our examination, Canada Post did not have some of the main elements in place that it required to address its financial needs. It did not share a common understanding with the federal government about its financial situation and was not able to gain the government's support on how best to manage this situation.

40. The Board and management are now working with the federal government to address the Corporation's financial needs and to change its financial framework to address long-standing problems and to ensure its financial viability. Canada Post actively and effectively communicated with the Strategic Review panel, and since the release of the panel's report, management has been meeting with representatives of the shareholder. Canada Post also belongs to a group of federally regulated corporations seeking changes to its pension solvency rules. At the conclusion of our examination work, these discussions were still under way. In addition to the increased interaction with the Minister, representatives of Canada Post have told us that relationships at other levels of the federal government have also been improving, but it is too early to see the results of these changes.

The Board has good practices to ensure the independence, knowledge, and skills it needs but continuity is threatened

41. The Board consists of the Chairman, the President, and nine other external members. At the end of our audit, there were no vacancies. However, the terms for two members expired in 2008, and by the end of 2009, the terms of five of the nine external members will have expired. If five new members were appointed in one year, the Board would lose significant knowledge that its members now retain. The Board could also experience gaps in skill sets. The Board is now requesting staggered terms for appointments to reduce the risk of significant turnover.

42. The Board has implemented procedures for identifying and managing conflicts of interest. These include declarations of conflicts of interest and recusal from meetings, as needed. Each year, the Board assesses its own performance. In March 2009, the Board approved an updated Directors Profile, which includes a list of core attributes, competencies, and experiences that each member should possess, as well as the qualities the Board needs as a whole. In May 2009, the Board also assessed the knowledge and skills of current members against this profile. It had not yet validated the results of this self-assessment by the end of our audit. We found that the Board also used outside expertise to complement its own knowledge when necessary—for example, in reviewing the proposal for the postal transformation initiative.

The Board has most of the information necessary to fulfill its responsibilities

43. **Information to the Board**. The Board has taken steps to identify the information it needs to fulfill its responsibilities. It has approved its committees' terms of reference and the orientation material it provides to new members. The Board has also approved annual schedules of committee meetings covering each committee's major areas of responsibility, as outlined in the terms of reference. The Board secretariat sends briefing material before meetings, including regular items for the Board's information or for decision. The secretariat also circulates updates on current issues, such as progress reports on the postal transformation initiative, the strategic review, and the pension fund.

44. In general, the Board receives relevant and timely information. However, we noted that it has received information about only some aspects of the Corporation's public policy objectives and compliance with legislative and regulatory requirements. For example, we found the Board receives only summary information on whether the Corporation has achieved the overall 1998 Policy Framework Lettermail™ delivery standards, while the Policy Framework specified separate standards for rural and urban delivery. The Board does not receive the individual breakdowns. We also found that the Corporation has not clearly defined its expectations for all of its public policy objectives, as discussed further in paragraph 68.

45. The Board receives various reports about corporate policies and on legislative and regulatory requirements, which in most cases give the Board sufficient information to assess compliance. Management could improve these reports by consistently providing the Board with assurance that they have identified all requirements, and describing the extent of Canada Post's compliance. For example, we found the December 2008 report on conflict of interest described the policy for employees and management's related processes, but it did not include the number of employees not complying with the requirements.

46. **Stewardship and oversight**. The Board has established a committee structure that supports its stewardship and oversight role. We found that the Pension Committee provides oversight for the pension fund. The Audit Committee invites external and internal auditors to attend all meetings and discusses audit plans, reports, and significant findings. The Board, through its Human Resources and Compensation Committee, oversees the performance of the President and considers succession.

47. During its annual strategic retreat and at other times, the Board provides management with strategic direction for the Corporation and direction on specific issues. For example, in 2008 the Board authorized management to request increased postage rates for letters to generate funding for the postal transformation initiative. The Board also exercises its challenge role. For example, in 2007 the Board asked that an external expert review the postal transformation plan. We noted that Board members also participate in ad hoc meetings to provide direction to management on issues such as the postal transformation initiative, management of the pension fund, and significant contracts.

The Corporation considers synergies with subsidiaries

48. **Information about subsidiaries.** Canada Post's subsidiaries are significant corporate assets. The Board has approved a governance model for its relationship with the subsidiaries. That model indicates that Canada Post's Board of Directors is responsible for ensuring alignment within the group of companies. The model also indicates that the subsidiaries need to provide timely information to the Canada Post Board about finances and risks related to the group. The Board's Audit Committee periodically receives financial information from the subsidiaries. The Corporate Plan, which the Board approves, includes information about the subsidiaries. From time to time, senior management of the subsidiaries have presented strategic issues to the Board. The Board considers synergies with the subsidiaries when approving changes in operations that could affect the subsidiaries.

49. **Conclusion on governance.** Overall, we found that while Canada Post has a well-functioning corporate governance framework with respect to Board stewardship to maximize its effectiveness and achieve its mandate, it could improve the information it provides to the Board on public policy objectives and compliance with laws and regulations.

Strategic planning, risk management, and performance measurement

50. Canada Post is a large and complex organization that is engaged in a large number of activities. The Corporation needs clearly defined strategic plans to coordinate its activities. It needs mechanisms to help it achieve its strategic plans, and mechanisms to consider the risks that could prevent the Corporation from achieving its objectives.

51. We looked at Canada Post's systems and practices for setting strategic direction, coordinating strategic and operational planning, and managing risks. We expected that Canada Post would have clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandate. As noted previously, the Board and management establish strategic direction during the annual strategic retreat. We expected that the Corporation's strategic direction and goals would take into account government priorities, identified risks, and the need to control and protect its assets and to manage its resources economically and efficiently. We expected that Canada Post would have a focus on risk embedded in its planning and operations.

52. We reviewed documents Canada Post used to develop plans, including documents the Board of Directors received for information and for approval, and documents managers and employees used to guide their work.

Canada Post coordinates its corporate planning well

53. Canada Post has a well-coordinated process to prepare its Corporate Plan. As previously noted, management and the Board establish strategic direction during the annual strategic retreat. We found that the Corporation collects information about its business environment by monitoring media reports, tracking events and trends affecting other national postal services, conducting market research, and consulting other sources. As part of the process, the Corporation prepares five-year projections of its financial performance, including that of its subsidiaries. Estimates of future revenue, Lettermail™ volume, and employee attrition (retirements and other employee departures) are important elements of these projections.

54. Canada Post has good mechanisms for developing and communicating its annual corporate priorities, based on the approved Corporate Plan. The Corporation includes the major annual priorities from the Corporate Plan on the corporate dashboard—a chart containing major corporate priorities and performance targets. Management uses the dashboard to monitor performance throughout the year. Canada Post links these priorities to the Corporate Team

Incentive, which is an employee bonus program, and to the President's personal performance objectives. We found that the Corporation communicates the Corporate Team Incentive program to employees. As further discussed in paragraph 66, the targets for these priorities are short-term.

The Corporation could improve operational planning and project implementation

55. **Coordinating strategic and operational plans.** As part of Canada Post's Corporate Plan process, each business unit summarizes its plans for the next five years. The Corporation uses these draft business plans to help develop the Corporate Plan. Following the Board's approval of the Corporate Plan, business units receive their resource allocations and senior managers receive individual scorecards with targets for the coming year. Each business unit then prepares some form of operational or tactical plan.

56. We found no consistent process for preparing the operational plans to ensure that they include the approved resources and detailed projects to support the Corporate Plan objectives for the coming year and beyond for longer projects. While we did not identify any misalignment between the operational plans and the Corporate Plan, the Corporation does not have a process to align the business units' operational plans with the strategic objectives that the Corporate Plan outlines. Further, the plans are not approved outside the business unit. The main tool Canada Post uses for coordinating plans among business units is a set of scorecards that are organized in a cascade through the ranks of management. Implementing a consistent process for preparing operational plans could give the Corporation additional assurance that its operational plans are complete, and might improve planning efficiency.

57. **Project approval.** Canada Post has implemented a highly structured and well-documented process for planning and approving individual projects, following the Stage-Gate® process. This process involves a series of approval processes, called gates, which each project must pass through as Canada Post refines and implements its plans. We found that the Corporation does not always execute the last stages well. Specifically, the Corporation does not track or assess the benefits of its projects well, although we noted some recent examples of management using assessments and deciding to cancel projects. The Board and management are closely monitoring the progress of the postal transformation initiative.

58. **Conclusion on strategic planning.** Overall, we found that Canada Post has set strategic direction and specific and measureable goals and objectives to achieve its mandate. For the most part, its strategic direction and goals take into account government priorities, identified risks, and the need to control and protect its assets and manage its resources economically and efficiently.

The Corporation is developing a corporate-wide approach to risk management

59. We found that management has risk management practices in place. At the request of the Audit Committee, Canada Post's Strategy group is establishing a rigorous approach to risk management. That approach includes creating a single corporation-wide list of major risks and rating those risks based on estimates of their significance and likelihood of occurrence. The group also assesses those risks against efforts to mitigate them. Although gaps in the process remain, the Strategy group is working on specifying risk tolerances and developing mitigation plans for all risks and indicators to track the changes in risks over time.

60. Several groups, such as the postal transformation team and Internal Audit, are assessing and reporting risks in different ways, and the Stage-Gate® process uses a checklist with different risk factors. Management considers risks in the corporate planning process, and the minutes of senior committee meetings show that they discuss risk mitigation. They could improve these various risk management practices by fully integrating them. The Strategy group plans to communicate its new approach to corporate managers and train them on how to use it.

61. **Conclusion on risk management.** We found that Canada Post has a focus on risk embedded in planning and its operations.

The Corporation lacks long-term performance targets

62. Canada Post needs performance information to monitor its progress in achieving strategic objectives and priorities, and to manage its resources economically, efficiently, and effectively.

63. We examined Canada Post's systems and practices for performance measurement and management, including the way it sets performance indicators, collects performance information, reports performance results, and uses performance information to inform its decision making. We expected that the Corporation would have identified and implemented performance indicators to measure whether it is achieving its legislative, commercial, and public policy mandate. We also expected that the Corporation would produce reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.

64. We reviewed documents that Canada Post used to develop performance targets and to report on its performance, including documents the Board of Directors received for information and for approval, and documents managers and employees used to guide and assess their work. We relied on the work of Internal Audit staff on Canada Post's Corporate Team Incentive, the Corporation's employee bonus program.

65. The corporate dashboard (a chart containing major corporate priorities and performance targets) includes specific performance measures and targets for each line of business. Canada Post updates the dashboard monthly, using performance information for the corporate priorities. The dashboard also includes measures of the four elements of the Corporate Team Incentive. We found that the Corporation emphasizes financial objectives and targets more than other aspects of performance. For example, we found that the financial elements of the Corporate Team Incentive have more impact on the amount of the bonus than the employee engagement, service, and customer elements. Management has indicated that this is appropriate in the current financial environment.

66. We found that management does not set performance targets beyond the current year, except in the case of financial measures. As part of the Corporate Plan process, the Corporation sets out detailed five-year financial objectives, but for the customer, service, and employee areas, it primarily sets one-year targets. We found that the measures on the senior management scorecards are aligned with the corporate dashboard and consequently are also short-term. Our recommendation is provided at paragraph 71.

67. We also found that the Corporation monitors its performance against the 2006 rural mail directive. In addition, it has established performance measures to evaluate delivery service, part of Canada Post's universal service obligation.

Exhibit 3 The Corporation has not clearly defined expectations for its public policy objectives and reported results for all of them

Public policy objectives identified by Canada Post *	Source	Performance measure (set out in the1998 Policy Framework)	2008 Results
[consolidated results]			
Financially self-sustaining	*Canada Post Corporation Act*	Earnings before interest and taxes—$175 million	$135 million
		Return on equity (ROE)—11%	6.1%
		Dividend to federal government payout ratio—25%; 40% once ROE is at or greater than 11%	40%
		Debt to capital ratio—40%	5.8%
		Productivity (cost of operations as a percentage of revenue)—97%	98.2%
[unconsolidated results]			
Universal service obligation	*Canada Post Corporation Act*	Lettermail™ service delivery (percent on time)—overall target not reported:	Overall—96%
		• two business days within the same metropolitan area or community—urban and rural targets not reported	• not reported
		• three business days within the same province—urban and rural targets not reported	• not reported
		• four business days between provinces—urban and rural targets not reported	• not reported
Parliamentary mail	*Canada Post Corporation Act*	None	
Material for the blind	*Canada Post Corporation Act*	None	
Library book rate	No formal requirement	None	
Maintain rural post office locations	Ministerial Policy Statement	None	
Publication Assistance Program (to March 2009)	Government directive (order-in-council)	None	
Rural delivery reinstatement	Government directive (order-in-council)	Quarterly report to the Minister (set out in the order-in-council)	Quarterly report to the Minister
Additional public policy objectives			
Fair and reasonable price for Lettermail™	*Canada Post Corporation Act*	None**	

* The Food Mail program, often listed by Canada Post as a public policy objective, is a service it provides under a contract with Indian and Northern Affairs Canada.

** Canada Post cites the price cap formula as set out in 2000 as providing fair and reasonable prices for Canadians.

Source: Canada Post annual reports and Conference Board of Canada report to Canada Post

Reporting on public policy performance could be improved

68. Canada Post includes information about its performance in its annual report. We noted that the delivery standards included in the Corporation's Policy Framework agreement are more detailed than the measure for delivery included in the annual report. The 2008 Annual Report states that the Corporation's delivery standards are to deliver Lettermail™ within two days within the same metropolitan area, three business days within the same province, and four days between provinces. However, the report only states that the Corporation's on-time performance was 96 percent overall. It does not break down performance based on those standards (Exhibit 3). We noted that Canada Post provided the shareholder with this information for 2007 but not for 2008. Canada Post reports quarterly to the Minister of Transport on how well it is complying with the 2006 directive concerning rural mail. However, the Corporation does not measure or report its performance on other public policy objectives in ways that could demonstrate to Canadians the benefits of these programs.

Canada Post uses performance information to manage operations

69. We found that management is using performance information to manage operations. For example, in 2008 the operations group set specific targets designed to increase productivity. Management monitored performance reports weekly and was able to save time by making better use of staff and finding ways for plant employees to work more efficiently. Canada Post's analysis shows that these efforts saved $70 million in labour costs.

70. **Conclusion on performance measurement.** Canada Post has identified and implemented performance indicators to measure the achievement of its legislative and commercial mandates and some elements of its public policy mandate. However, these measures are generally short-term. We found that the Corporation also produces reports that provide complete, accurate, timely, and balanced information for decision making. However, Canada Post needs to improve its accountability reporting on its public policy objectives.

71. **Recommendation**: Canada Post should provide more focus to its strategic goals and public policy objectives by

- articulating clear mid- and long-term objectives by setting targets beyond the current year, and
- setting targets for all its public policy objectives and reporting against them.

The Corporation's response. *Canada Post agrees with the recommendation and will review its current corporate dashboard and implement multi-year performance targets in non-financial areas, where appropriate.*

Canada Post is proud to provide services in accordance with its public policy objectives. In our 2009 Annual Report we will provide expanded information about our activities in these areas to more fully demonstrate to Canadians the cost and benefits of these programs.

In September 2009, the government established a postal service charter, which defines its expectations for Canada Post's service standards and related activities. In conjunction with reporting on the standards in the charter, Canada Post will establish performance targets for its public policy programs where appropriate.

Postal transformation initiative

72. Canada Post views the upgrading of its infrastructure under the postal transformation initiative as the cornerstone of its vision for the Modern Post. Management expects this initiative to address three main strategic objectives for its operational network: modernizing the core of its infrastructure, increasing productivity, and building the foundation for new or improved products and services through automation.

73. We examined the Corporation's plans, strategies, systems, and practices for planning, implementing, and monitoring the postal transformation initiative. We expected that Canada Post would have comprehensive plans, strategies, systems, and practices in place to successfully plan, implement, and monitor its postal transformation initiative.

74. We reviewed the postal transformation initiative planning documents, status reports, risk logs, and updates to senior management and to the Board of Directors. We selected a sample of the major components of the initiative to determine whether the Corporation has developed business cases and obtained the necessary approvals for these components.

The postal transformation initiative was well-planned and monitored

75. **Planning the postal transformation initiative**. In the fall of 2007, the Board of Directors approved a detailed plan for the postal transformation initiative. This plan was a conceptual model that identified milestones, lead times for equipment acquisition, and preliminary layouts for the Winnipeg plant, which is the plant in greatest need of replacement. Management hired an independent consulting firm to review the plan. The firm concluded that the plan was well thought out, with rigorous analysis; had reasonable cost estimates; and was based on best practices for global postal service. This review further identified some areas for change to mitigate major risks, including the need to shorten the timeline to capture savings sooner and thus improve the expected return on investment.

76. Management also hired consultants to do an independent analysis of the delivery network. Canada Post used this analysis to develop a plan to restructure its delivery network. We found that the Corporation's planning documents clearly define deliverables, timelines, approval requirements, inputs, and areas of responsibility. The Corporation considered the environmental impact of replacing plants and equipment.

77. **Managing the implementation.** We found that, during the annual corporate planning process, the postal transformation team communicated with representatives from all three lines of business to help understand and align the postal transformation initiative with their needs. In addition, the team consulted the lines of business and other affected stakeholders within Canada Post about design and implementation decisions affecting their areas of responsibility.

78. Canada Post has developed a charter for the postal transformation initiative and has established several senior committees to oversee it. The charter outlines the rationale for the initiative, as well as the main strategy, mission, and major risks. One major component of the project management structure is a formal process for all changes to the master program schedule. The process specifies roles and responsibilities required to initiate, support, and obtain approval for major changes to milestones, deliverables, and scope. The Chief Operating Officer approves changes affecting the lines of business.

79. We found that for individual program components, the postal transformation team prepares business cases, including detailed assumptions and cost and benefit estimates, and also monitors project progress through the execution phase. Stakeholders within Canada Post review and sign off on these business cases. We also found that the postal transformation team follows the roles and responsibilities outlined in the project charter. In some cases, the thresholds for approvals are lower than those for other corporate transactions. This requirement recognizes the high risk of this initiative and its strategic importance.

80. **Monitoring the initiative**. The postal transformation team receives monthly individual project reports. The team consolidates this information and prepares reports on the progress of the overall initiative. We reviewed a sample of monthly project progress reports and found they included project achievements, deliverables, milestones, costs, changes in risks, and action plans. The postal transformation team prepares monthly summary reports for senior management, the senior committees, and the Board of Directors. Canada Post has developed a separate risk management process for this initiative. We examined a sample of risk logs and related reports and found that the postal transformation team routinely identifies, assesses, prioritizes, monitors, and promptly remediates risks. The Corporation has begun implementing a benefits management process intended to monitor monthly progress in achieving expected benefits.

81. **Conclusion on the postal transformation initiative.** As noted earlier, the Corporation may not be able to implement the postal transformation initiative fully because it lacks sufficient funding. Otherwise, we found that Canada Post has comprehensive plans, strategies, systems, and practices in place to plan, implement, and monitor its postal transformation initiative.

Infrastructure

82. Canada Post is a capital-intensive company. Most of its mail-processing plants are more than 40 years old, and many of its facilities, operational assets, and other processing equipment are near the end of their useful life and will soon require significant upgrades or replacement. While the Corporation has invested in electronic services to grow the business, there is a significant risk that the Corporation will not meet its delivery standards because of equipment breakdowns or other disruptions in the operational network.· Canada Post hires third parties for many other services critical to the Corporation's operations, such as transportation, building maintenance, and information technology services.

83. We reviewed the Corporation's systems and practices for acquiring, maintaining, modifying, and replacing its material assets. We examined Canada Post's procurement selection and monitoring processes for strategic contracts. We reviewed the terms and conditions of the contracts. In addition, we examined the systems and practices Canada Post had in place to manage its long-standing outsourcing arrangement for information technology services. We expected that Canada Post would have plans, systems, and practices in place for acquiring, maintaining, modifying, and replacing its material assets, and for its arrangements with key suppliers. We also expected that Canada Post would use these plans, systems, and practices to ensure continuity of its operations and to meet its current and future requirements cost-effectively.

84. We examined capital asset planning and budgeting, asset maintenance, capital and repair expenses, and contingency planning documents for a sample of mail processing plants and facilities. We also reviewed a sample of strategic contracts.

Capital investment is a priority but information for decisions may be incomplete

85. **Asset management**. Canada Post has detailed processes to plan, prioritize, approve, and manage projects for real estate repairs and maintenance, vehicle and operational equipment replacement and maintenance, and the purchase of postal and mail boxes. The Corporation prepares plans based on its future needs, considering changes anticipated under the postal transformation initiative, building condition reports from facilities management contractors, preventive maintenance schedules for vehicles and equipment, and forecasted needs for new community mailboxes. Canada Post establishes budgets to distribute funds over its portfolio of assets; however, its yearly budget of under $50 million is less than the estimated cost of the required repairs and maintenance. Between 2004 and the end of 2008, the estimated cost of outstanding repairs and maintenance increased to more than $300 million from about $200 million. The Corporation's strategy is that the postal transformation initiative will address some of this backlog.

86. Management reviews and monitors the asset management plans as required during the year. As the following details indicate, we found that Canada Post may have incomplete information for planning its asset management activities, and some of the information is difficult to use.

- Facilities management contractors prepare building condition reports, but Canada Post does not validate the contractors' cost estimates for repairs and maintenance until it enters into contracts. In addition, the reports, particularly for smaller buildings, do not consistently consider a life cycle approach. We also noted that the Corporation frequently reallocates its limited repair and maintenance budget because of the need to address urgent issues as they become health and safety concerns that it had not previously identified for attention that year.
- The company that supplied the vehicle maintenance information system that Canada Post uses no longer supports it. The system is old and inflexible, with limited ability to provide reports to users.
- The Corporation's equipment maintenance information system is very labour- intensive. It does not allow the Corporation to track

the maintenance done on major equipment accurately, thereby limiting Canada Post's ability to readily identify specific pieces of equipment that are at higher risk of failure.

87. In March 2009, the Corporation changed its organizational structure and moved real estate managers to regions throughout Canada. Management informed us that this will allow the Corporation to validate the costs included on the building condition reports. Canada Post is planning to adapt its systems and practices to accommodate new accounting standards, because Canada is adopting International Financial Reporting Standards. As part of this change, the Corporation will collect data on the age and useful life of various building components. This will provide the required data to support a life cycle management system, which management needs for the estimated $2.4 billion of major capital assets the Corporation plans to purchase under the postal transformation initiative. In addition, the Corporation has begun some work on replacing both the vehicle and equipment maintenance information systems. Our recommendation can be found at paragraph 95.

88. **Contingency plans.** We found that Canada Post has identified the essential processes needed to carry out its business. It has prepared business continuity plans for them for catastrophic events, such as a pandemic, failure of the data centre, or breakdown of major pieces of equipment used across the country. Facilities management contactors have developed contingency plans for the structural parts of each building. The contactors keep these plans, and the plant manager and the asset management group have access to them on line. Management told us that in 2009 they expect to develop a plan for an extended plant closure or shutdown. We found that when equipment at one major facility failed, Canada Post successfully executed contingency plans to convert to manual processes.

Canada Post's contracting with its related companies needs improvement

89. Canada Post follows well-defined processes for contracting with suppliers, including using process description documents, various templates for contract terms and conditions, a file content checklist, and other tools. Typically, the Corporation requests competitive bids and evaluates proposals using pre-defined criteria to select a supplier. Senior management, and in some cases the Board, approves procurement strategies for large or complex contracts. Occasionally, the Corporation uses fairness commissioners to review complex contracts, such as those relating to the postal transformation initiative.

90. We reviewed two significant contracts with the Corporation's related companies and found that the terms and conditions might not protect Canada Post's interests. We noted that a significant portion of the payments under these contracts is retained within the Canada Post group of companies.

91. We looked at the process for the 2008 Purolator contract for domestic air delivery services and concluded that the contracting process Canada Post followed to award the contract was appropriate given the timelines and the Corporation's operational requirement to deliver the mail (see the case study on page 31). The contract is a cost-plus contract, which is common in the air freight industry. However, we found that it has little incentive for Purolator to control costs, and it does not penalize Purolator for excessive costs. Canada Post analyzed the negative factors in the contract and determined that, overall, the contract was reasonable.

92. In 2002, Canada Post entered into a contract with Innovapost Inc., a joint venture that Canada Post and CGI Group own, for information technology services. Canada Post owns 51 percent of the joint venture and holds the majority of seats on the Board. The terms and conditions of the contract did not adequately protect the Corporation. For example, Canada Post has conducted benchmarking studies as permitted under the contract. However, the prices have not been adjusted as a result of these studies, and Canada Post has no remedy to force price reductions other than through the contract dispute resolution process. We found that management has recently taken steps to make improvements within the constraints of the contract and, in our view, they are doing everything they can to manage a difficult situation. For example, Canada Post monitors service levels based on regular reports Innovapost provides, and the Corporation meets regularly with representatives of Innovapost. Under the terms of the contract, Canada Post must give notice by November 2009 if it does not intend to renew the contract beyond May 2012. Management is currently reviewing the situation.

93. Although the Corporation has a contract monitoring checklist, we found that the level and type of monitoring was inconsistent among contracts. Canada Post could improve the way it monitors supplier performance by validating the self-assessment information that suppliers provide on their own performance.

94. **Conclusion on infrastructure.** Overall, we found that Canada Post has plans, systems, and practices in place for the acquisition, maintenance, modification, and replacement of its capital assets, and for its arrangements with major suppliers. In general, we found that Canada Post uses these plans, systems, and practices to ensure continuity of its operations and to meet its current and future requirements cost-effectively, except for the funding of the postal transformation initiative, as previously discussed. However, the Corporation could improve its

Awarding of the Purolator Contract

In early 2008, in light of its need for cash to fund postal transformation, Canada Post began talking to its air freight suppliers to explore ways to improve efficiency and save money. Shortly afterwards, Air Canada demanded five changes to its existing contracts with the Corporation, which Canada Post estimated would cost an additional $15 million per year. At that time, Air Canada was providing three major air freight services to Canada Post: domestic mail, international mail, and US mail. Canada Post procurement staff met Air Canada officials to try to negotiate reduced fees. On 16 May 2008, the President of Air Canada Cargo faxed Canada Post's president, indicating that Air Canada was exercising its right to terminate its contract with 120 days' notice. The contract would expire on 13 September 2008.

Canada Post immediately began to consider how to replace its entire air freight network in just four months. The Corporation had contracts in place with other suppliers for international mail and much of its US mail. It replaced these Air Canada services by increasing the volume it shipped with the other suppliers. Canada Post is currently undertaking a formal Request for Proposal (RFP) process to find a new supplier or suppliers when the current contracts for international mail expire.

The Corporation did not have similar contracts with other suppliers that it could use to replace Air Canada's domestic air freight operations. The Corporation assembled a team of operational experts to analyze the situation. The team selected five air freight companies with which Canada Post already had contracts, including Air Canada. While air freight is excluded under the North American Free Trade Agreement (NAFTA) contracting requirements, Canada Post's practice is to follow the NAFTA RFP process for large contracts to ensure that its contracting decisions are not challenged. Based on a detailed analysis of timelines, the team determined that there was insufficient time to use an RFP process for domestic freight. The International Mail RFP process has subsequently confirmed the domestic decision, because it has taken about 12 months to put in place a contract to handle about 300 lanes, or routes, of freight. A lane is similar to booking a one-way passenger flight from one city to another. The domestic freight contract requires more than 500 lanes.

On 22 May 2008, Canada Post issued a Request for Information (RFI) to four of the five selected air freight operators, asking them to respond by 4 June 2008. It assembled a team of experts in finance, purchasing, operations, and air transportation. According to Canada Post, Air Canada declined to consider operational changes included in the RFI. The team evaluated the response from the other four carriers, using criteria for start date, capacity, risk, and opportunities for lower cost or higher revenue. A key factor was the cost of fuel. The team presented the results of this analysis to the Chief Operating Officer on 4 June 2008. Based on this analysis, Canada Post concluded that Purolator Courier Ltd. was the only operator offering to meet both the volume capacity and time frame requirement that would enable it to start by 14 September 2008.

In keeping with its policy on strategic sourcing, Canada Post management presented its analysis of the situation to the Board of Directors on 5 June 2008, recommending a sole-source contract using the RFI process. The Board approved this strategy.

Canada Post began a dual process of negotiating a contract with Purolator and preparing for the operational transition. Senior vice-presidents received weekly progress briefings. At the Board meeting on 13 August 2008, management indicated that Purolator was the only viable carrier and it had entered into contract negotiations. The information provided to the Board included a high-level description of proposed details of the contract. A major deciding factor was that Purolator would not include any mark-up on the cost of fuel.

On 12 September 2008, Canada Post received an assessment of the proposed terms of the contract from an independent third-party expert in air freight. Although the assessment was based on limited information due to the five-day time frame for the assessment, it listed a number of positive and negative factors about the agreement. Canada Post analyzed the negative factors and determined that, overall, the contract was reasonable and would cost less than the increased rates Air Canada had proposed. However, as noted in paragraph 91, we found that the contract was missing some cost control terms we would have expected to see.

Canada Post seamlessly transferred its domestic air freight to Purolator from Air Canada on 15 September 2008. The President and CEO signed the contract with Purolator on 8 October 2008, retroactive to 10 September 2008, for a period of five years. The Board gave its final approval on 16 October 2008.

processes for managing its buildings by validating the cost estimates provided by the facilities management contractors and by consistently applying a life cycle process. Canada Post also needs to ensure that the terms of contracts with its related companies protect the interests of Canada Post.

95. **Recommendation.** Canada Post should improve its processes for managing its buildings by validating the cost estimates provided by the facilities management contractors and by consistently applying a life cycle process.

The Corporation's response. *Canada Post agrees with the recommendation concerning the importance of life cycle management and, as indicated in the report, is currently planning for the replacement of both the vehicle and equipment maintenance information systems.*

Since the estimates received from facilities management contractors are used only in portfolio-level planning activities, we are satisfied that they have a sufficient degree of precision for this type of exercise. In addition, we expect to see continued improvement in this area with the realigned organizational structure referred to in this report. The primary control to ensure that real estate repairs and maintenance activities are performed in a cost-effective manner is the established contracting process whereby any repair and maintenance projects exceeding $5,000 are subject to a Request for Proposal process, which ensures that the Corporation receives competitive bids through the facility management contractors.

96. **Recommendation**. Canada Post should ensure that the terms of contracts with its related companies sufficiently protect the interests of Canada Post.

The Corporation's response. *Canada Post agrees with the recommendation that contracts with related parties should sufficiently protect the interests of the Corporation and, in the case of the two contracts reviewed by the auditors, a number of measures were provided for by the contract in this regard. In the case of the Purolator contract, the Corporation negotiated an incentive clause for cost reductions, an annual audit clause, a revenue-sharing arrangement for the usage of excess capacity, and a straight cost pass-through structure for fuel costs. Regarding the Innovapost contract, the Corporation has taken steps to protect its interests by withholding a portion of certain amounts in dispute and, as provided for within the contract, the parties are addressing the issue through the dispute resolution process.*

Human resources management

97. Human resources management, a core function for any corporation, is particularly important for Canada Post, with nearly 60,000 employees who individually and collectively contribute to the achievement of corporate objectives.

98. We looked at systems and practices in the Human Resources and Operations groups that relate to human resources planning, staffing, retention, learning and training, performance management, employee engagement, health and safety, and labour relations. We expected that Canada Post would manage human resources in a manner that provides the human resources capacity and the work environment it needs to achieve its goals and objectives.

99. We reviewed human resources documents that dealt with aligning the activities of the human resources function with corporate strategy and with managing workforce attrition and turnover. We reviewed a sample of plans for managing the succession of critical positions. We reviewed training and development plans and reports. We examined a sample of employee scorecards, performance appraisals, and performance improvement plans. We analyzed the results of the annual employee survey, examined various communications to employees about health and safety and other issues, and reviewed a sample of the minutes from joint management and union committee meetings.

The Corporation has adopted processes to ensure enough qualified employees

100. We found that Canada Post has several processes in place to manage its human resources capacity. The Corporation creates an annual human resources business plan, aligned with the Corporation's strategic direction. Senior members of the human resources team are responsible for implementing the plan, and their performance scorecards reflect the plan's major objectives. Canada Post conducts annual workforce planning and prepares reports on upcoming employee attrition and turnover rates. The Corporation also monitors forecasts of mail volumes and hires temporary staff to meet processing requirements when needed. Canada Post has developed succession plans for senior positions, as well as plans to mitigate the risks involved if critical positions become vacant.

101. From time to time, Canada Post has used external firms to supplement its staffing capabilities when it needs to hire large numbers of people. Currently, Canada Post is meeting its internal and external recruiting through its own resources. The Corporation is implementing a new applicant tracking system to manage staffing requests and to produce metrics to evaluate their hiring process. Management advised us that 2009 will be the base year for measuring performance.

102. Overall turnover rates at the Corporation in 2008 were lower than other companies, including the federal government, so retention is not currently an issue. However, the turnover rates for staff in certain groups with less than five years of service are higher than the overall average. Management may need to take steps to reduce turnover if retirement rates increase over the next few years, as expected.

The Corporation for the most part ensures that employees have necessary skills

103. Collective agreements outline job descriptions and expectations for most of Canada Post's front-line employees. Performance management plans or performance scorecards outline the annual objectives for managers and all other employees. The Board of Director's Human Resources Committee sets the President's scorecard objectives, based on the annual corporate business plans. These objectives are cascaded throughout the organization from upper management down to the lowest level. The vice-presidents are responsible for ensuring that the objectives of their own teams are complete and individual employees' goals are aligned with business objectives.

104. The Corporation evaluates employee performance annually. The process identifies individuals who are excelling, those with advancement potential, and those who are poor performers. Canada Post is implementing a new talent management system to link performance management and career development. Management advised us that they will link this system to the succession planning process. Supervisors prepare performance improvement plans for employees identified as needing improvement. However, we found that the Corporation has no systematic way to alert management if improvement plans are missing for any employees.

105. In 2009, Canada Post increased its emphasis on providing training for employees, by including targets for learning and development in its employee bonus program, the Corporate Team Incentive. We found that the information systems are not yet in place to provide the metrics for this index. Currently, the Learning and Development Group calculates the index manually. We also found that although the Corporation collects ad hoc information about certain training programs, it does not consistently evaluate its training programs to assess the participants' understanding of the training material and ability to apply the training in the workplace.

Management is taking steps to build this type of evaluation but it is too early to see improvements in the effectiveness of employee training.

The Corporation is gradually improving its work environment

106. Canada Post's annual employee surveys include questions to measure the level of employee engagement. The results have been improving for the last three years, but overall, the satisfaction level is still low, compared with other postal and logistics companies around the world. Scores are low particularly among the mail carriers and mail processing workers, who are not satisfied, for example, with opportunities for personal development and growth. Scores are much higher among other groups of workers, such as retail, sales, and service employees. Management uses the survey results to develop action plans. For example, senior managers coach and mentor front-line leaders who have frequent contact with employees and may be able to influence employee engagement scores.

107. Health and safety is the highest-weighted objective on the scorecards for managers supervising operations. External audits have identified health and safety risk areas across the Corporation. Canada Post has begun developing action plans for each priority area the audits identified as requiring improvements, and it is including those steps in its overall health and safety plans. However, we found that management does not have detailed information about the nature of workplace accidents and near misses, or about related trends that could inform their decision making. Management told us that in 2010 they plan to implement new processes to collect accident information. In July 2007, Canada Post implemented a new disability management program. Since then, the number of people coming back to work resuming their normal duties instead of modified duties has increased to 65 percent from 50 percent. The Board receives regular information on health and safety issues through its Corporate Social Responsibility, Environment and Health and Safety Committee.

108. Developing and maintaining good relations with its four unions is a critical activity for Canada Post. The Corporation has established numerous committees to foster good communication with these unions. While there is a large backlog of grievances, there is also a good system in place to assess those grievances as they are received, and to sort them according to their complexity. We found that management has good processes in place to prepare for union contract negotiations and obtain Board approval prior to beginning negotiations. At the end of our audit, all union contracts were current.

109. **Conclusion on human resources.** Overall, we found that Canada Post manages human resources in a manner that provides the human resources capacity and the work environment it needs to achieve its goals and objectives.

Customer relationship management

110. Canada Post serves every business and household in Canada by delivering letters and by providing a variety of competitive postal products and services. The Corporation needs to understand the customers for its competitive products, so that it can plan and implement efficient sales coverage, and target effective marketing campaigns to the groups most likely to respond. Effective customer relationship management is critical to attract and retain customers who purchase Canada Post's competitive products and services, and to earn revenue while keeping costs as low as possible.

111. We examined systems and practices in the Marketing, Sales and Service group and in the Corporation's three lines of business. We assessed them for the way they categorize groups of customers, measure customer satisfaction, and manage new product development. We also looked at the Strategy and Finance groups' systems and practices for analyzing prices, developing proposals for rate increases, and measuring delivery costs. We expected that Canada Post would manage customer relationships based on a sound understanding of customer demand and satisfaction, application of customer segmentation (categorization) strategies, and application of tailored relationship management strategies to achieve revenue and margin objectives.

112. We reviewed documents defining categories of customers and assessing customer needs. We also looked at sales and marketing plans, customer service plans and initiatives, and documents monitoring sales performance and customer satisfaction. We reviewed documents relating to Canada Post's costing policy and costing system, and we looked at how Canada Post uses this information. We reviewed the projects for new and improved products and services approved or ongoing during the period of our audit. We also looked at examples of recently completed projects.

The Corporation's practices are adequate to manage customer relationships and pricing

113. **Categorizing customers.** Canada Post divides its customer sales at several levels to facilitate sales planning and management. The Marketing Sales and Service group uses information on current sales and estimates of future sales to categorize customers. Based on this information, the group organizes its sales resources to focus on the most significant groups of customers. The Parcels and the Direct Marketing lines of business have identified subcategories based on customers' purchasing patterns. They use this information to develop and deliver targeted marketing campaigns. The Marketing and Strategy groups have done some initial work to develop a common structure for categorizing customers. Management expects that this common structure will be the starting point for a revised approach to planning and managing marketing activities that focuses more on the customer. Refining the categories of customers and coordinating the results of the separate processes would provide management with better information. Management told us they expect that a common approach to categorizing customers will be necessary to improve the Corporation's customer focus and to develop a new long-term market vision.

114. **Monitoring satisfaction.** Management monitors customer satisfaction in several ways. Customers contact Canada Post by telephone or email through a network of call centres. Customer service employees analyze these calls and messages to identify the causes of customers' issues and areas for improvement. Canada Post also measures and tracks customer loyalty using a Customer Value Index. This index is the percentage of surveyed customers who give Canada Post high ratings regarding the overall quality and value of Canada Post and the likelihood they will recommend Canada Post to friends or colleagues. Canada Post conducts other surveys to learn customers' views on factors that influence their loyalty, such as the range of products, delivery, price, reputation, and image.

115. **Pricing.** Regulations under the *Canada Post Corporation Act* limit the Corporation's ability to increase the basic domestic letter rate to two thirds of the increase in the Consumer Price Index. The Governor in Council approves rate increases for domestic letters. In developing rate proposals for all other products, the Pricing Strategy group considers a variety of market and cost factors, including the estimated impact on revenue and profit margin.

The Corporation needs to improve product development processes

116. The Corporation's three lines of business also use the Stage-Gate® process to identify, screen, and prioritize new product development projects. As mentioned previously for strategic projects, we found that the Corporation has not defined the final step of the process clearly to plan for transition and assess the achieved benefits. Consequently, we found that the Corporation does not consistently apply this final step for these projects. We reviewed a sample of new product development projects and noted that many are components of larger product development initiatives. This means that the success of these overall initiatives depends upon the successful implementation of a series of projects. We found that new product development priorities were not consistently included in each line-of-business plan to provide context and direction for Canada Post's new product development process.

117. Canada Post could improve its new product development process by consistently assessing the results from projects to identify the costs and benefits achieved, and to identify and share lessons learned. Establishing high-level product development strategies in each line-of-business plan would also provide more direction to new product development.

118. **Conclusion on customer relationship management.** Overall, we found that Canada Post manages customer relationships based on an understanding of customer demand and satisfaction, on the application of customer segmentation strategies, and on tailored relationship management strategies designed to achieve revenue and margin objectives.

Conclusion

119. We examined Canada Post Corporation's systems and practices in the areas of governance, strategic planning and risk management; performance measurement, monitoring, and reporting; human resources management; infrastructure; postal transformation; and customer relationship management. Our objective was to determine whether those systems and practices provide Canada Post Corporation with reasonable assurance that its assets are safeguarded and controlled, its resources are managed economically and efficiently, and its operations are carried out effectively.

120. We noted a significant deficiency relating to the strategic risk due to the lack of funding for the postal transformation initiative. We found that the Corporation has good systems and practices for corporate governance, strategic planning, risk management, human resources management, postal transformation, and customer relationship management. The Corporation could improve its performance measurement practices by setting targets beyond the current year and for all its public policy objectives. The Corporation also needs to improve its systems and practices for infrastructure management by verifying cost estimates, consistently applying a life cycle process, and improving the terms of contracts with its related companies.

About the Special Examination

All of the audit work in this report was conducted in accordance with the standards for assurance engagements that The Canadian Institute of Chartered Accountants set. While the Office of the Auditor General and KPMG adopt these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objective

Under section 138 of the *Financial Administration Act* (FAA), federal Crown corporations are subject to a special examination once every 10 years. Special examinations of Crown corporations are a form of performance audit where the scope is set by the FAA to include the entire corporation. In special examinations, the examiner provides an opinion on the management of the corporation as a whole. The opinion for this special examination is found on page 5 of this report.

Special examinations answer the question: Do the corporation's systems and practices provide reasonable assurance that assets are safeguarded and controlled, resources are managed economically and efficiently, and operations are carried out effectively?

Key systems and practices examined and criteria

At the start of this special examination, we presented the Corporation's audit committee with an audit plan that identified the systems and practices and related criteria 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. These are the systems and practices and the criteria we used for examination.

Key system and practice examined	Criteria
1. Governance and compliance	Canada Post has a well-functioning corporate governance framework with respect to Board stewardship, including balancing its public policy and commercial objectives, managing subsidiaries, and complying with laws and regulations, to maximize its effectiveness and achieve its mandate.
2. Strategic planning and risk management	Canada Post has clearly defined strategic directions and specific and measurable goals and objectives to achieve its legislative, commercial, and public policy mandate. Its strategic direction and goals take into account government priorities, identified risks, and the need to control and protect its assets and manage its resources economically and efficiently. Canada Post has a focus on risk embedded in planning and in its operations.
3. Performance measurement, monitoring, and reporting	Canada Post has identified and implemented performance indicators to measure the achievement of its legislative, commercial, and public policy mandate. It also has reports that provide complete, accurate, timely, and balanced information for decision making and accountability reporting.

4. Human resources	Human resources are managed in a manner that provides Canada Post with the human resources capacity and the work environment it needs to achieve its goals and objectives.
5. Infrastructure	Canada Post has plans, systems, and practices in place for the acquisition, maintenance, modification, and replacement of its material assets, and for its arrangements with key suppliers. Canada Post uses these plans, systems, and practices to ensure continuity of its operations and to meet its current and future requirements cost-effectively.
6. Postal transformation	Canada Post has in place comprehensive plans, strategies, systems, and practices to successfully plan, implement, and monitor its postal transformation initiative.
7. Customer relationship management	Canada Post's customer relationship management is based on a sound understanding of customer demand and satisfaction, application of customer segmentation strategies, and the application of tailored relationship management strategies to achieve revenue and margin objectives.

The Board reviewed and accepted the suitability of the criteria used in the audit.

Audit work completed

Our examination covered the systems and practices in place between February 2008 and May 2009. We also examined certain matters that preceded the starting date of the examination. Audit work for this special examination was substantially completed on 15 May 2009. We extended our examination period to 10 August 2009 to consider events related to the postal transformation initiative.

Audit team and resources

Office of the Auditor General	**KPMG**
Leads	
Assistant Auditor General: Nancy Y. Cheng Principal: Crystal Pace Director: Margaret Haire	Partner: Barry Lalonde Associate Partner: Nancy Chase
Team	
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Quality Reviewers	
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Appendix List of recommendations

The following is a list of recommendations found in the Special Examination Report. The number in front of the recommendation indicates the paragraph where it appears in the report. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
The Modern Post	
35. Canada Post should follow up with the government to secure the funding relief to allow the Corporation to complete its transformation to the Modern Post. Also, it should update the detailed costs and benefits analysis to show the feasibility of the postal transformation initiative and to show the payback, which would be an important step to ensure the Corporation's financial sustainability and allow it to deliver on its mandate in the long term. **(23–34)**	Canada Post agrees with the recommendation concerning the need to secure the funding to allow the Corporation to complete its transformation to the Modern Post. The Corporation has been actively discussing this with the government and had indicated its need for government support for the initiative in its 2009–2013 Corporate Plan as well as its 2008 submission to the Strategic Review panel. As noted in this report, Canada Post has recently received positive reaction to the idea of a multi-year pricing strategy and an increased borrowing limit and, in October 2009, received government approval for both of these funding components. The Corporation will continue to work with the government in its pursuit of financial self-sustainability, including support for the transformation initiative. In addition, the Corporation is in the process of completing a detailed cost and benefit analysis to confirm the benefits associated with a phased implementation of the postal transformation initiative. As we proceed through each phase of the initiative, we will continue to prioritize our activities based on those components that address our most critical operational needs and that have the highest return on investment. We will also maintain our practice of presenting detailed plans, based on the most up-to-date information available, to the Board for their approval.

Recommendation	Response
Strategic planning, risk management, and performance measurement	
71. Canada Post should provide more focus to its strategic goals and public policy objectives by • articulating clear mid- and long-term objectives by setting targets beyond the current year, and • setting targets for all its public policy objectives and reporting against them. **(50–70)**	Canada Post agrees with the recommendation and will review its current corporate dashboard and implement multi-year performance targets in non-financial areas, where appropriate. Canada Post is proud to provide services in accordance with its public policy objectives. In our 2009 Annual Report we will provide expanded information about our activities in these areas to more fully demonstrate to Canadians the cost and benefits of these programs. In September 2009, the government established a postal service charter, which defines its expectations for Canada Post's service standards and related activities. In conjunction with reporting on the standards in the charter, Canada Post will establish performance targets for its public policy programs where appropriate.
Infrastructure	
95. Canada Post should improve its processes for managing its buildings by validating the cost estimates provided by the facilities management contractors and by consistently applying a life cycle process. **(82–88)**	Canada Post agrees with the recommendation concerning the importance of life cycle management and, as indicated in the report, is currently planning for the replacement of both the vehicle and equipment maintenance information systems. Since the estimates received from facilities management contractors are used only in portfolio-level planning activities, we are satisfied that they have a sufficient degree of precision for this type of exercise. In addition, we expect to see continued improvement in this area with the realigned organizational structure referred to in this report. The primary control to ensure that real estate repairs and maintenance activities are performed in a cost-effective manner is the established contracting process whereby any repair and maintenance projects exceeding $5,000 are subject to a Request for Proposal process, which ensures that the Corporation receives competitive bids through the facility management contractors.

Recommendation	Response
96. Canada Post should ensure that the terms of contracts with its related companies sufficiently protect the interests of Canada Post. **(89–94)**	Canada Post agrees with the recommendation that contracts with related parties should sufficiently protect the interests of the Corporation and, in the case of the two contracts reviewed by the auditors, a number of measures were provided for by the contract in this regard. In the case of the Purolator contract, the Corporation negotiated an incentive clause for cost reductions, an annual audit clause, a revenue-sharing arrangement for the usage of excess capacity, and a straight cost pass-through structure for fuel costs. Regarding the Innovapost contract, the Corporation has taken steps to protect its interests by withholding a portion of certain amounts in dispute and, as provided for within the contract, the parties are addressing the issue through the dispute resolution process.