

Spring 2012



Report of the Auditor General of Canada to the House of Commons

**Message from the Auditor General
Main Points—Chapters 1 to 5
Appendix**



Office of the Auditor General of Canada

OAG

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Auditor General of Canada
Vérificateur général du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith this 2012 Spring Report to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(5) of the *Auditor General Act*.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Michael Ferguson".

Michael Ferguson, FCA

OTTAWA, 3 April 2012

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Message from the Auditor General—Spring 2012

Message from the Auditor General— Spring 2012



Michael Ferguson, FCA
Auditor General of Canada

I am pleased to present my first report to Parliament as Auditor General of Canada.

This report addresses a wide range of issues that illustrate some of the challenges facing government today:

- ensuring at the border that commercially imported consumer goods identified as potential health and safety risks conform with applicable Canadian laws and regulations;
- acquiring major defence equipment through decisions that commit the government to a course of action well into the future;
- managing Canada's interest-bearing debt;
- improving compliance with the *Income Tax Act* among those who are required to file a tax return or to register for GST/HST but who fail to do so; and
- overseeing whether aviation companies are complying with the policies, regulations, and standards required for the safety of civil aviation within Canada's borders.

The sheer magnitude of operations in the programs we examined is impressive. For example:

- The Canada Border Services Agency processed and released 13 million shipments of commercial products in the 2010–11 fiscal year.
- National Defence has budgeted \$9 billion to acquire 65 F-35 fighter jets and \$16 billion to operate and sustain them over 20 years.
- The government's interest-bearing debt managed by the Department of Finance Canada totalled \$802 billion at 31 March 2011; the interest charges that year, \$30.9 billion, represented 11.4 percent of government expenses.
- The Canada Revenue Agency's Non-Filer/Non-Registrant program generated \$2.8 billion in additional taxes, interest, and penalties assessed in each of the 2009–10 and 2010–11 fiscal years.

- Transport Canada oversees the safety practices of the second largest civil aviation aircraft fleet in the world, accounting for nearly three million flights in 2010.

With areas of responsibility on such a large scale, governments must make choices in their day-to-day operations about which services to deliver and where to focus their activities to best serve the public good. In times of fiscal restraint, choices become tougher and trade-offs must be made. Some government organizations discussed in this report are managing this challenge; others need to improve.

Border Controls on Commercial Imports

Potentially unsafe products entering Canada without appropriate controls carry risks that could include illness or even death. The volume of imports into Canada is so large that it is not practical to apply controls at the border to every shipment that enters. In order to balance the requirement to examine shipments with the need to facilitate the free flow of goods, federal organizations responsible for product safety need to identify high-risk shipments on which to focus controls at the border. These controls include administering import requirements; targeting high-risk shipments, both automatically and through border lookouts; and examining intercepted shipments.

We found that in most cases, the consumer goods in our audit that pose a risk to health and safety are adequately controlled at the border by the Canada Border Services Agency (CBSA) and the federal organizations responsible for them. However, some controls need to be better managed and the results better monitored by all the organizations involved, so they know whether they are directing their resources at the highest risks.

Replacing Canada's Fighter Jets

This chapter looks at two separate but related activities in National Defence. One was its participation, starting in 1997, in the United States-led, international Joint Strike Fighter program to design, develop, and manufacture the F-35 Lightning II fighter aircraft. The other was the process to acquire the F-35 as the replacement for the fleet of CF-18 Hornet fighter jets.

National Defence and Industry Canada recognized that Canada's participation in the Joint Strike Fighter (JSF) program provided opportunities for industrial benefits to Canada, and they took appropriate steps to help Canadian industry take advantage of those

opportunities. In contrast, National Defence did not recognize early enough that its involvement in the program had procurement implications. Consequently, it did not engage Public Works and Government Services Canada (PWGSC) early enough to establish a suitable process, consistent with procurement rules and including appropriate safeguards, to manage a project of this nature and magnitude.

When National Defence decided to recommend the acquisition of the F-35, it was too involved with the aircraft and the JSF Program to run a fair competition. It applied the rules for standard procurement projects but prepared key documents and took key steps out of proper sequence. As a result, the process was inefficient and not managed well. Key decisions were made without required approvals or supporting documentation. Information provided to decision makers was incomplete, and no plan was developed for extending the life of the CF-18 fleet in the event of prolonged delays in the delivery of a jet that is still being developed.

For its part, PWGSC, in its role as the government's procurement authority, did not do enough to ensure the integrity—the fairness and transparency—of the procurement process.

National Defence did not follow the basics of good management that would be expected for a \$25 billion commitment by the government. It is important that a purchase of this magnitude follow a rigorous, transparent process.

Interest-Bearing Debt

Public debt and the associated interest charges consume a large amount of financial resources. They affect the government's fiscal strength, limit policy choices, and influence what we can afford as a nation. The interest-bearing debt therefore needs to be managed and reported on properly. Clearer information allows for better policy debate, including debate on how to keep public finances sustainable.

We found that the Department of Finance Canada has a sound decision-making system in place to support and develop effective market debt strategies. It has a risk management framework that allows it to respond to emerging risks and changes in funding requirements. However, the Department needs to improve its monitoring of and reporting on the overall performance of the debt management strategy to inform management decisions. And while Canada is a leader in reporting its public sector pension plan liabilities in its financial

statements, financial information on the pension plans is dispersed among several reports, making it difficult to readily understand the potential impact of these liabilities.

Non-Filers and Non-Registrants—Canada Revenue Agency

Income tax is the single most important source of government revenue. For the income tax system to operate fairly and effectively, all individuals and corporations need to file returns when the law requires it, and pay the taxes they owe. Not doing so reduces the amount of money available for important government programs such as health care, education, and environmental protection. Similarly, businesses that are required to register for GST or HST, but that fail to do so, may have a negative impact on government revenues.

We found that overall, the Canada Revenue Agency's Non-Filer/Non-Registrant program works, but there is room for improvement. The Agency has not integrated its research and past experience into its planning in order to improve the program. It has validated its process for selecting files to pursue, but not for rejecting files. It needs to determine the effectiveness of both in order to ensure that it is not focusing on files with little to no tax potential.

Oversight of Civil Aviation—Transport Canada

While Canada compares favourably with many other countries in its aviation safety record, any deterioration would significantly impact public confidence. This makes it critical that Transport Canada maintain a robust and effective regulatory framework for civil aviation safety. The Department's civil aviation safety program puts the onus on large aviation companies to develop safety management systems in accordance with regulations, while the Department oversees their compliance.

We found that Transport Canada has made real progress in its new approach to safety oversight. It has revised its surveillance methodology to be consistent with this approach, and its rigorous regulatory framework for civil aviation safety is consistent with international standards. However, the Department can take a long time to address emerging safety concerns—in some cases, more than 10 years. We also found that the Department is not adequately managing the risks associated with its oversight of civil aviation. There are weaknesses in how it plans, conducts, and reports on its surveillance activities. For example, in the 2010–11 fiscal year, only two thirds of planned inspections were carried out—which is significant, since only

the higher-risk aviation companies are selected for inspection in any given year. In addition, Transport Canada has not yet identified how many inspectors and engineers it will need to oversee civil aviation—something it agreed to do in 2008 when we recommended it.

Special Examinations of Crown Corporations—2011

The final chapter in this report presents the main points of special examination reports on Crown corporations that were issued to the corporations' boards of directors between 1 January 2011 and 31 December 2011 and that the corporations subsequently made public. A special examination is an important accountability mechanism for Crown corporations. It provides an independent opinion on whether there is reasonable assurance that a Crown corporation has systems and practices in place to ensure 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. Any major weakness in the key corporate systems and practices that could prevent a corporation from achieving those objectives is reported as a significant deficiency.

I am pleased to note that we found no significant deficiencies in our 2011 special examinations of the Canadian Dairy Commission, the Canadian Race Relations Foundation, and the Public Sector Pension Investment Board.

Conclusion

The government's decisions have significant consequences for the citizens of this country. In the current environment of managing with less, the challenge for public servants is to maximize the potential benefits of choices and trade-offs and to minimize negative consequences.

On a personal note, I would like to acknowledge the efforts by staff of the Office of the Auditor General to make my introduction to the Office a smooth transition for everyone, even in the midst of our own operational review. I have joined a strong institution, with people who approach the work of the Office with dedication and professionalism. I look forward to working with them, with Members of Parliament, and with government officials to meet the challenges that Canada faces over the next decade.

Main Points—Chapters 1 to 5

Border Controls on Commercial Imports

Chapter 1 Main Points

What we examined

Under various acts and regulations, federal government organizations are responsible for ensuring the safety of commercially imported consumer goods that have been identified as a risk to the health and safety of Canadians. The Canada Border Services Agency (CBSA) is tasked with ensuring that commercially imported consumer goods enter Canada in conformity with applicable laws and regulations.

To achieve this, the CBSA works with other federal government organizations to implement controls at the border. Controls at the border include administration of import requirements (for example, permits and authorizations), detection and interception of shipments targeted by federal organizations as high risk or non-compliant, and examination of selected shipments for admissibility into Canada. These controls are part of a broader product safety regime that also includes both pre- and post-border controls, such as licensing and market surveillance, and is supported by importers' voluntary compliance. The regime is intended to control any high-risk products that are allowed to enter the country and thereby help ensure the safety of imported products in the marketplace.

We examined the part of the product safety regime that is implemented at the border. Looking at selected commercially imported goods—including fertilizers, health products, pest control products, consumer products, consumer fireworks, vehicles, and tires—we examined how the CBSA, the Canadian Food Inspection Agency, Health Canada, Natural Resources Canada, and Transport Canada work together to ensure that products comply with applicable legislation when they enter Canada.

Audit work for this chapter was substantially completed on 30 September 2011. Further details on the conduct of the audit are in **About the Audit** at the end of this chapter.

Why it's important

The volume of imports into Canada is so large that it is not practical for federal organizations to apply border controls to every shipment, nor is it necessary. According to the CBSA, it processed and released 13 million shipments of commercial products in the 2010–11 fiscal year, about four million of which were subject to federal import requirements. Federal organizations must balance the requirement to examine shipments with facilitating the free flow of goods. To do this, they need to have systems and practices that can identify and concentrate on high-risk shipments of commercially imported products.

Potentially unsafe products entering Canada without appropriate controls carry risks that could include illness and death. Even a less serious incident can have a significant effect on Canadian consumer confidence in imported products.

What we found

- In most cases, imported consumer goods in our audit that pose a risk to the health and safety of Canadians are adequately controlled at the border by the Canada Border Services Agency, the Canadian Food Inspection Agency, Health Canada, Natural Resources Canada, and Transport Canada. With a few exceptions, the administration of import requirements and automatic targeting of high-risk shipments are working as intended.
- In the small percentage of cases where goods that did not meet import requirements were allowed to enter the country, most were products for which there was no agreement in place between Health Canada and the CBSA. While the CBSA has formal arrangements with the three other organizations in our audit, as yet it has no formal agreement with Health Canada that documents respective roles, responsibilities, policies, and procedures for implementing controls on several products under Health Canada's responsibility, such as medical devices and pest control products. Until there is a formal agreement, border services officers do not have consistent instructions on procedures to follow for those products.
- Border lookouts and examinations are reserved for higher-risk shipments and they consume resources, yet their results are poorly documented. For example, examination results were recorded incorrectly or incompletely in 40 percent of cases we examined. Consequently, we could not determine whether the examinations are working as intended, nor can the organizations requesting them. Moreover, among the audited organizations there are gaps in the monitoring of all three border controls. For example, the CBSA's target monitoring reports are inaccurate and incomplete. These gaps

make it difficult for federal organizations to know how well the controls are working and where resources and effort can be directed most effectively to manage risk.

The entities have responded. The entities agree with all of the recommendations. Their detailed responses follow the recommendations throughout the chapter.

Replacing Canada's Fighter Jets

Chapter 2 Main Points

What we examined

Canada currently operates a fleet of CF-18 Hornet fighter jets purchased in the 1980s with an original life expectancy until 2003, since extended to between 2017 and 2020 after a modernization program in early 2000. National Defence has determined that a suitable replacement for the CF-18 is required, or it will lose its ability to carry out domestic and international missions mandated by the Government of Canada.

National Defence has been a partner in the Joint Strike Fighter (JSF) Program since 1997. Led by the United States, and with eight other country partners, the Program is undertaking concurrent design, development, and manufacturing of the F-35 Lightning II aircraft. It will eventually include a regime for long-term collaborative sustainment. Canada's participation has been formalized by signing international memoranda of understanding—in 1997, 2002, and 2006—for each of the three major phases of the JSF Program. As of September 2011, the government had disbursed about CAN\$335 million toward participation in the JSF Program and related support to Canadian industry. The government has committed a total of US\$710 million to the Program.

In May 2008, through the *Canada First Defence Strategy*, the federal government announced its intent to replace the CF-18 fleet with 65 “next generation” fighter aircraft. Then, in July 2010, the government announced its decision to buy the F-35 Lightning II, without following a competitive process, as the CF-18 replacement.

We examined whether National Defence, Industry Canada, and Public Works and Government Services Canada exercised due diligence in managing Canada's participation in the JSF Program and in managing the federal decision-making process to acquire the F-35 as a replacement for the CF-18.

Our conclusions relate only to the management practices and actions of public servants. We did not audit private sector contractors and, consequently, our conclusions do not pertain to the contractors' practices or to their performance. We did not audit the merits of the F-35 aircraft.

Audit work for this chapter was substantially completed on 30 September 2011. Further details on the conduct of the audit are in **About the Audit** at the end of this chapter.

Why it's important

Buying major defence equipment is subject to decision-making and project management processes whose aim is to ensure that decisions are well founded, projects are managed effectively, and goods and services are acquired in a way that enhances supplier access, competition, and fairness. National Defence, Industry Canada, Public Works and Government Services Canada (PWGSC), and central agencies are involved.

Buying and maintaining the F-35, or any other fighter jet, will require a significant long-term financial commitment. The F-35 is still being developed and tested, and projections of purchase price and sustainment costs are still being refined. Decisions taken to date as well as those yet to come will have impacts for the next 40 years.

What we found

- National Defence took the appropriate steps in managing Canada's participation in the Joint Strike Fighter (JSF) Program to develop the F-35. National Defence engaged Industry Canada early, and together they managed industrial participation well. Early efforts to secure contract opportunities for Canadian companies were successful.
- There were significant weaknesses in the decision-making process used by National Defence in acquiring the F-35 to replace the CF-18. By the end of 2006, the Department was actively involved in developing the F-35, and a number of activities had put in motion its eventual procurement. In the lead-up to the government's 2010 announcement, required documents were prepared and key steps were taken out of sequence. Key decisions were made without required approvals or supporting documentation.
- PWGSC did not fully carry out its role as the government's procurement authority. Although it was not engaged by National Defence until late in the decision-making process, PWGSC endorsed the key decision to sole source the acquisition of the F-35 in the absence of required documentation and completed analyses. By that time, practically speaking, Canada was too involved with the aircraft and the JSF Program to run a fair competition.
- National Defence did not provide complete information in a timely manner. For example, briefing materials prepared for decision makers did not explain the basis for and limitations of projections of industrial benefits to Canadian companies, and the risks of relying on the projections for decision making. In addition, briefing materials

did not inform senior decision makers, central agencies, and the Minister of the problems and associated risks of relying on the F-35 to replace the CF-18. Nor did National Defence provide complete cost information to parliamentarians.

- National Defence likely underestimated the full life-cycle costs of the F-35. The budgets for the F-35 acquisition (CAN\$9 billion) and sustainment (CAN\$16 billion) were initially established in 2008 without the aid of complete cost and other information. Some of that information will not be available until years from now. If the budgets prove insufficient to cover total costs, the Department will have to find ways to cover additional costs that may be incurred. Alternatively, it may have to seek additional funds from the government or use funds from other parts of its capital or operating budgets.

The departments have responded. National Defence agrees with our recommendation. Its response follows the recommendation.

National Defence, Industry Canada, and Public Works and Government Services Canada have accepted the facts presented in the chapter. Both National Defence and Public Works and Government Services Canada disagree with the conclusions set out in paragraphs 2.80 and 2.81.

Interest-Bearing Debt

Chapter 3 Main Points

What we examined

Debt management refers to how the Government of Canada raises funds to meet its borrowing requirements, what it decides and does about the composition of the market debt, and how it governs these activities. The Government of Canada's interest-bearing debt is made up of principally two sets of liabilities: market debt and public sector pension plan liabilities. Market debt is the part of the debt that the government borrows in financial markets and that is managed by the Department of Finance Canada. It totalled \$597 billion at 31 March 2011. Public sector pension plan liabilities are part of the non-market debt. These liabilities represent the government's obligations to the employee pension plans of the public service, Canadian Forces, and Royal Canadian Mounted Police (RCMP). They totalled \$146 billion at 31 March 2011.

Together, market debt and the pension plan liabilities make up over 92 percent of the interest-bearing debt, which totalled \$802 billion at 31 March 2011. In 2010–11, interest charges on the debt totalled \$30.9 billion and represented 11.4 percent of government expenses.

We examined how the Department of Finance Canada develops strategies to manage market debt. We looked at its risk management practices and at how it monitors and reports on performance of the debt-funding strategy. We also examined how the Department of Finance Canada and the Treasury Board of Canada Secretariat report information about charges on the interest-bearing debt as well as the budgetary impact of the public sector pension plan liabilities.

Audit work for this chapter was substantially completed on 31 October 2011. Further details on the conduct of the audit are in **About the Audit** at the end of this chapter.

Why it's important

Debt management is the federal government's largest program (after transfers to seniors and to other levels of government). How market debt is managed has a direct impact on the government's fiscal strength. Debt managers need to set appropriate market debt strategies using robust processes and tools—first, to balance costs and risks so

that low-cost and stable funding can be raised, and second, to support well-functioning markets for Government of Canada securities.

Deteriorating sovereign debt conditions in the Euro zone and in the United States show the importance of having sound debt strategies, as they provide stability and assurance to market participants. Sound debt strategies will also support the fiscal sustainability of public finances in the long term.

In addition to market debt, public sector pension plan liabilities and associated debt charges have a large impact on the government's fiscal situation. It is therefore important that Canadians be provided with clear information on that debt, the associated interest charges, and their impact on budget deficits or surpluses. The significant amounts involved can influence policy choices by limiting what the government can afford to do.

What we found

- In developing its debt strategies, the Department of Finance Canada uses a sound process that relies on a detailed and robust debt strategy model and on the judgment of senior managers as well as on consultations with dealers and investors. The model and the qualitative/quantitative analyses help debt managers recommend preferred debt structures, and are major advances since our last audit 12 years ago.
- The Department is monitoring and achieving the objective of a well-functioning market for Government of Canada securities. Until recently, it was using metrics that did not provide a full assessment of the extent to which it was achieving the objective of raising low-cost, stable funding for the Government of Canada by arriving at a desired debt structure that strikes a balance between costs and risks. Subsequent to the period under review, the Department started monitoring better the extent to which it balances costs and risks, but it cannot yet demonstrate that the debt strategy is achieving the low-cost, stable funding objective. While the Department publishes clear information on the market debt, it could publish more details to indicate why a particular debt strategy was chosen and how well the program is performing.
- The Department of Finance Canada has a sound risk management framework in place to assess and monitor emerging risks as well as changes in financial requirements that could affect the debt strategy. However, it does not promote Government of Canada securities to market participants as well as it could to appeal to a broader base of investors.

- Canada is a leader among member countries of the Organisation for Economic Co-operation and Development (OECD) in recognizing in its financial statements the obligations arising from public sector employee pension plans. In fact, very few other countries report these obligations on their financial statements. However, while complete financial information on the pension plans is available, it is dispersed among several reports and not presented in easy-to-read formats. It is therefore difficult for parliamentarians and Canadians to readily understand the potential impact of these liabilities on the budgetary balance and how they influence policy choices. In addition, the composition of projected interest charges reported in the Estimates is not clearly presented. Finally, the Department of Finance Canada does not have timely access to the quarterly updates from the Public Sector Pension Investment Board about actual returns on public sector pension investments, which would help the Department assess the impact that unforeseen fluctuations could have on budget surpluses or deficits.

The entities have responded. The entities have agreed with our recommendations. Their detailed responses follow the recommendations throughout the chapter.

Non-Filers and Non-Registrants— Canada Revenue Agency

Chapter 4 Main Points

What we examined

The Canada Revenue Agency works to ensure that Canadians pay their required share of taxes and that the revenue base is protected. It is responsible for administering the *Income Tax Act*, which specifies when taxpayers are required to file a return. A non-filer is an individual, a corporation, or a trust who fails to file a tax return as required by legislation.

Under the *Excise Tax Act*, businesses that meet certain criteria are required to register for the goods and services tax/harmonized sales tax (GST/HST). Non-registrants are businesses that fail to comply with this requirement.

The Agency, through its Non-Filer/Non-Registrant (NF/NR) program, works to encourage individuals, corporations, and trusts to comply with the filing requirement and, in the case of businesses, with the GST/HST registration requirements. In the 2010–11 fiscal year, the NF/NR program's salary budget was \$39 million of the Agency's total budget of \$4.5 billion, and it employed 700 of the Agency's approximately 39,000 employees. This relatively small program area generated \$2.8 billion of additional taxes, interest, and penalties assessed in each of the 2009–10 and 2010–11 fiscal years.

We looked at what the Agency has done to address non-compliance with filing and registration requirements. The audit focused on how the Agency identifies non-filers and non-registrants and how it plans, monitors, and reports on its actions to improve compliance.

Audit work for this chapter was substantially completed on 5 January 2012. Further details on the conduct of the audit are in **About the Audit** at the end of the chapter.

Why it's important

Income tax is the single most important source of government revenue. For the income tax system to operate fairly and effectively, it is important that all individuals and corporations file returns when they are required by law to do so, and that they pay the taxes they owe. Not doing so reduces the amount of money available for important government programs such as health care, education, and the

environment. Similarly, businesses that are required to register for GST or HST, but do not, may have a negative impact on government revenues. The Agency has identified non-filers and non-registrants as high-priority issues to address, as part of its efforts to combat non-compliance, including the underground economy.

What we found

- Because the Agency does not have the resources to pursue all non-filers, it has developed a risk-scoring model to identify those it will pursue. Agency analysis indicated that the files it chooses to pursue result in returns filed and taxes assessed. However, it has not tested its screening to determine whether the files it chooses not to pursue from the initial 2.5 to 3 million files identified by the matching process should in fact be pursued. In addition, two thirds of the files initially selected for pursuit in the field are later determined to have low potential, and work on them is discontinued. In other words, the Agency does not know if its risk-scoring process is as effective as it could be.
- The Agency uses identification projects to find taxpayers who may be participating in the underground economy. The majority of projects completed were meeting or exceeding their targets for number of tax returns filed and amounts assessed.
- The Agency's planning process tends to repeat actions from one year to the next to identify non-filers and non-registrants. While it considers the cost of its processes to pursue these files when planning work, the Agency is not taking advantage of its research findings in its work plans in order to improve its results in achieving compliance.
- Current performance indicators focus on routine program activities—for example, tax dollars and the number of taxpayers assessed—rather than on the longer-term impact of the program, in particular the Agency's success at getting non-compliant taxpayers to change their behaviour and file their returns. Various audits and program evaluations over the years have recommended action to develop additional performance measures and risk management of the Non-Filer/Non-Registrant (NF/NR) program and to improve its use of internal and external information. The Agency has made limited progress in implementing many of these recommendations.

The Agency has responded. The Agency agrees with all of the recommendations. Its detailed responses follow the recommendations throughout the chapter.

Oversight of Civil Aviation— Transport Canada

Chapter 5 Main Points

What we examined

Aviation companies that want to operate commercially in Canada must obtain an authorization. In 2011, there were more than 5,000 companies authorized to operate and more than 34,000 aircraft registered in Canada. To maintain their authorization to operate, these companies must meet the minimum safety standards required for the safe conduct of civil aviation.

The minimum safety standards for aviation companies fall under the *Aeronautics Act* and the *Canadian Aviation Regulations*. The Act and the regulations form the main part of the regulatory framework for civil aviation. The overall responsibility for the maintenance of safe, regular, and efficient civil aviation operations, including the manufacturing and maintenance of aircraft, rests with the aviation industry.

Transport Canada is responsible for developing and administering the policies, regulations, and standards required for the safe conduct of civil aviation within Canada's borders. The Department is also responsible for overseeing whether aviation companies have complied with this safety framework, and for taking appropriate enforcement action where necessary. In 2009–10, Transport Canada spent over \$148 million and dedicated about 1,400 employees to monitoring civil aviation across Canada.

Our audit examined whether the Department has managed the risks associated with overseeing its civil aviation safety program. We focused on Transport Canada's surveillance of air carriers, aircraft maintenance organizations, and airports in the National Airports System.

Audit work for this chapter was substantially completed on 30 September 2011. Further details on the conduct of the audit are in **About the Audit** at the end of this chapter.

Why it's important

Transport Canada plays a key role in helping to ensure that Canada's civil aviation safety framework meets minimum international safety standards. While Canada compares favourably with many other countries in its aviation safety record, any deterioration would significantly impact public confidence. This makes it critical that

Transport Canada maintain a robust and effective regulatory framework for civil aviation safety, especially since the International Civil Aviation Organization (ICAO) has projected a significant growth in aviation until 2025.

Identifying aviation companies that present safety risks is a highly complex process that relies heavily on the judgment and experience of Transport Canada's inspectors across Canada and on the information that is made available to them.

The Department's inspectors cannot be continuously present in all aviation companies to assess their compliance with aviation safety standards. Consequently, Transport Canada must use risk management techniques to decide where, when, how often, and in how much depth it inspects aviation companies in order to obtain sufficient assurance that they are complying with Canada's aviation safety requirements. If Transport Canada does not manage these surveillance risks well, it is unlikely to focus its scarce resources on aviation companies and operations that represent the highest risks.

What we found

- Transport Canada has developed a rigorous aviation safety regulatory framework that is consistent with standards established by the International Civil Aviation Organization, but it can take a long time to address emerging safety issues—in some cases, more than 10 years. The Department has yet to fully implement a process that will address these issues more quickly.
- Since 2008, Transport Canada has made progress in evolving from the traditional surveillance approach—largely based on responding to regulatory requirements—to a systems-based approach designed for large and small aviation companies. This approach allows for more consistent and rigorous surveillance of aviation companies' compliance with safety regulations.
- While some aspects of the new surveillance program are working well, there are weaknesses in critical areas. For example, information for assessing the risk indicators that Transport Canada uses to identify the high-risk aviation companies that should be inspected is not always available or kept up to date. A minimum acceptable level of surveillance has not been clearly established to indicate how long aviation companies can operate without being inspected, and only two thirds of planned inspections have been carried out. Most inspections are not fully conducted according to established methodology and are subject to little management oversight.

In addition, documentation of key decisions is weak. Finally, Transport Canada lacks a quality assurance program to continuously improve its surveillance program.

- Transport Canada recently developed a national human resources plan for the oversight of civil aviation to help ensure that it has the resources it needs to carry out its safety regulatory program. However, the plan does not specify the number of inspectors and engineers that are needed, although the Department agreed to provide these figures in its response to our 2008 recommendation. The Department has made progress with implementing key human resources strategies, but efforts to fully implement the new surveillance approach have been hampered by the lengthy reorganization and by resistance from some inspectors.

The Department has responded. The Department agrees with all of our recommendations. Its detailed responses follow each recommendation throughout the chapter.

Appendix

Appendix Report on the audit of the President of the Treasury Board's *Annual Report to Parliament on the Tabling of Crown Corporations' Reports 2011*

Tablings in Parliament for parent Crown corporations: Annual reports and summaries of corporate plans and budgets

Section 152 of the *Financial Administration Act* (the Act) requires the President of the Treasury Board to lay before each House of Parliament, a report on the timing of the tabling, by appropriate ministers, of annual reports and summaries of corporate plans and of budgets of Crown corporations. This report must be tabled by 31 December.

The Act requires the Auditor General of Canada to audit the accuracy of the President of the Treasury Board's report on the timing of tabling and to present the results in his annual report to the House of Commons.

The President of the Treasury Board's *Annual Report to Parliament on the Tabling of Crown Corporations' Reports 2011* was tabled on 9 December 2011.

At the time that our Fall 2011 report was going to print, we were unable to include the results of the above audit, since the President of the Treasury Board's report had not yet been finalized. Our auditor's report was subsequently appended to the President's report and is reproduced in this report to Parliament.

Auditors' Report

To the House of Commons:

As required by subsection 152(2) of the *Financial Administration Act*, I have audited, for the year ended 31 July 2011, the information contained in the *Annual Report to Parliament on the Tabling of Crown Corporations' Reports 2011*. The information contained in the report is the responsibility of the President of the Treasury Board. My responsibility is to express an opinion on the information contained in the report based on my audit.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the information contained in the report is free of significant misstatement. My audit included examining, on a test basis, evidence supporting the dates and other disclosures provided in the report.

In my opinion, the information contained in the *Annual Report to Parliament on the Tabling of Crown Corporations' Reports 2011* is accurate, in all significant respects, with the section "Deadlines for tabling in Parliament" contained within the report.



Lucie Cardinal, CA
Principal
for the Interim Auditor General of Canada

2 November 2011
Ottawa, Canada