2006

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

MAY

Office of the Auditor General of Canada

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 2006 to the House of Commons, which is to be tabled in the House in accordance with the provisions of subsection 7(5) of the *Auditor General Act*.

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 16 May 2006

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Sheila Fraser, FCA
Auditor General of Canada

A Message from the Auditor General of Canada

I am pleased to present my fourth Status Report to the House of Commons.

In addition to the Status Report, I am issuing a report entitled Government Decisions Limited Parliament's Control of Public Spending. The issues covered in that report came to our attention during our audit of the Canadian Firearms Program.

As Parliament's auditor, the Office of the Auditor General plays an important role in promoting government accountability and well-managed public administration in Canada. Our performance audits provide parliamentarians with fact-based information they can rely on in their oversight of government spending and performance on behalf of Canadians.

The essence of parliamentary control of the public purse lies in the ability of the House of Commons to establish an annual cap on the amount of money that the government may spend on each of its identified areas of activity and in holding the government to account for respecting those limits on its spending.

The ability of Parliament to exercise control depends on the government's production of good spending estimates in the first place and, at year-end, on the fair presentation of actual spending in departmental accounts. Only if this is done can Parliament be assured that its authority will not normally be exceeded and, in those rare cases when it is, that it will be in a position to exercise its duty of holding the government to account.

Decisions by the government not to seek authority when required, or not to account fully for expenditures against a Vote where an over-expenditure is likely, could be viewed as limiting Parliament's ability to control the public purse.

We found that the Canada Firearms Centre—on the advice of the Treasury Board Secretariat and legal advisors—did not submit Supplementary Estimates in 2003–04, even though it was aware that it was likely to exceed its 2003–04 spending limit authorized by Parliament. Furthermore, it also decided—again on the advice of the Secretariat and legal advisors—not to record as 2003–04 expenditures $21.8 million of costs incurred for the Canadian Firearms Information System II. Had these costs been recorded, the Centre would have exceeded its voted appropriation for that year.

In our opinion, those decisions were contrary to the *Financial Administration Act* and the government's stated accounting policies.

Actions taken to avoid seeking proper authority for supplementary appropriations could be interpreted as a breach of the Standing Orders of the House of Commons. Failure to fully account to Parliament for expenditures against a Vote could also be viewed as an infringement of the privileges of the House of Commons. However, only the House itself can determine whether such a breach has occurred. The Standing Committee on Public Accounts may wish to pursue this matter further if it considers that to be appropriate.

Status Report

Once a year, I prepare a report for Parliament called the Status Report. This report focusses on what the government has done to address recommendations made in a selection of previous performance audits. It answers the question: Does government take action in response to the Auditor General's reports? We look at the steps departments have taken to resolve issues we have reported in the past, and we assess whether progress has been satisfactory, given the complexity of the issues involved and the amount of time the departments have had to act. This report assists parliamentarians in their efforts to hold the government accountable for its stewardship of public funds.

Taken as a whole, the eight chapters in this year's report paint a picture of mixed progress. For half the chapters, we conclude that overall progress has been unsatisfactory. For the other half, we are reporting satisfactory progress, while clearly highlighting the problems that still concern us. This is the case for the chapter on the Canadian Firearms Program. While we are reporting that the Canada Firearms Centre has made satisfactory progress on the single recommendation made in our 2002 audit, we continue to have concerns about the quality of data in the firearms registration database, the development of CFIS II, and the Centre's performance reporting.

For our chapter on the management of programs for First Nations, we undertook work that went beyond our usual follow-up of previous audits. In addition to looking at how well five federal organizations had implemented 37 recommendations on First Nations issues reported between 2000 and 2003, we identified factors that appear to have been critical in successfully implementing our recommendations. We explored the conditions that had contributed to positive action or whose absence had hindered it. We think this knowledge can be used to improve the chronically slow rate of progress on issues that are critical to First Nations communities.

Management of Voted Grants and Contributions

Every year, the government spends about $17.5 billion on voted grants and contributions, which require Parliament's approval through an annual appropriation. When we last reported on the management of grants and contributions in 2001, we noted weaknesses in the way departments assessed applications for funding, managed risk, and exercised financial controls, especially controls over payments to the recipients of funds.

This year we found that, overall, the government has made satisfactory progress in managing grants and contributions. Four of the five departments we looked at clearly document their assessments of funding applications, and they have in place management systems, a risk-based approach to monitoring funded activities, and training for officials working in grants and contributions programs. The sole exception was Indian and Northern Affairs Canada, the largest federal spender on grants and contributions, which has weaknesses in all these areas.

However, departments have not received clear direction on when to use a grant and when to use a contribution in designing programs. Moreover, the available types of transfer payments set out in the Policy on Transfer Payments issued by the Treasury Board do not meet departmental needs. Requirements to establish a program are not clearly linked to the definitions of types of transfer payments. In response, some programs have created types of transfer payments that exhibit elements of both grants and contributions.

Recipients of grants and contributions have expressed concerns about the way departments apply the Policy on Transfer Payments. For example, organizations with long-term projects may have to reapply annually and demonstrate their eligibility for funding, even when they have received grants or contributions year after year and the departments already have the required information. This results in added administrative costs for recipients and wasted time and resources for departments. We found that although some efforts have been made, departments and the Treasury Board Secretariat have yet to streamline their management of grants and contributions in ways that would resolve such concerns.

National Defence—Military Recruiting and Retention

The Canadian military is embarking on a major transformation that includes increasing its regular forces by 5,000 members over the next five years. This expansion has been identified as a priority in order to meet operational demands.

In 2002 we reported that the Department of National Defence was having difficulty both recruiting enough people to meet operational demands and addressing the reasons members were leaving the military, particularly those in some key military occupations. This year we found that, overall, the Department has made satisfactory progress in responding to our recommendations. However, problems remain. The Department has shown some improvement in recruiting the military personnel needed to meet operational requirements, yet it is barely replacing the members who are leaving. While it has recruited about 20,000 new members since our 2002 audit, the number trained and available for duty has increased by only 700.

Recruiting and attrition problems are jeopardizing the Canadian Forces' planned expansion. Faced with a changing Canadian demographic profile, a low level of interest among Canadian youth in joining the military, and increasing military operational demands, the current recruiting and selection process is not meeting the needs of the Canadian Forces. The Department needs to address the problems that prevent it from getting the right number of suitable candidates from which to select recruits.

Further, National Defence forecasts an increase in the number of members who will leave the military over the next 10 years. Because the Department has not measured the impact or tracked the progress of the retention strategy it developed in 2001, it cannot demonstrate that the strategy has helped to increase the trained effective strength or resolve shortages in key military occupations.

National Defence has begun to take military human resources management into account in its long-term strategic planning for the Canadian Forces. However, policies, systems, and practices have yet to reflect the new strategic direction of the Canadian Forces.

National Defence—NATO Flying Training in Canada

In May 1998, National Defence entered into a $2.8 billion, 20-year contract to purchase pilot training as part of the NATO Flying Training in Canada program. With the participation of more foreign nations, this contract has since increased to about $3.4 billion. Our 2002 Status Report noted concerns about the management of both the program and the contract. Because of the contract's restrictive nature and problems with the aircraft, the Department had paid about $65 million for training that was either not available or was not used before the end of December 2001.

Our follow-up audit found that overall, National Defence has made satisfactory progress toward resolving the problems we reported in 2002 and has recently reached an agreement with the contractor to compensate the Crown for the cost of training missed prior to December 2002, which had grown to about $89 million.

However, since December 2002, National Defence has experienced other problems with the program and, as a result, paid about $39 million for flying training that it could not use because too few pilots were enrolled in the program. It appears that the Department has no recourse to recover this loss. We believe that this training shortfall is likely to continue for at least a few more years.

Canadian Firearms Program

In 2002, we reported that we were unable to complete our audit of the costs of the Canadian Firearms Program, because the financial information was unreliable and did not fairly present the net costs of the program. We also said that the Department of Justice was not giving Parliament enough information to allow for effective scrutiny of the program or to explain the dramatic increase in its costs. We made only one recommendation in 2002: The Department of Justice should rectify these gaps in financial reporting.

Our follow-up audit found that the Canada Firearms Centre, now a separate agency, has made satisfactory progress in implementing that recommendation, except in accounting for the costs of the new information system it is developing. In two cases, significant costs of the Canadian Firearms Information System (CFIS) were not recorded in the correct fiscal year, contrary to government policies for appropriation accounting. Had the costs been recorded correctly, in 2002–03 the Centre would have exceeded by $17.1 million the spending limit stated by the Minister of Justice. Because the 2002–03 costs were not recorded until 2003–04, recording the new costs for 2003–04 in that year would have required additional funding through the use of Supplementary Estimates.

The new management team appointed to the Canada Firearms Centre in 2003 has started to address many of the organizational issues facing the Centre. However, problems remain. The Centre has not assessed the quality of the data in the firearms registration database and does not know how many of its records are incomplete. Its plans for resolving concerns about data quality hinge on a network of volunteer verifiers. We have several concerns about the operations of this network.

Before the new management team arrived in 2003, the contracts for the CFIS were poorly managed. The system being developed to replace it, CFIS II, is significantly over budget. Some of the increased costs are due to the fact that development began before legislation and regulations were in place. Project delays have contributed to about one third of the total cost, now expected to be at least $90 million.

The Centre's performance reports do not give Parliament a complete picture of how well the licensing and registration activities are performing. The Centre has no formal process for following up with law enforcement on its licence refusals and revocations, and therefore it cannot report on their impact.

Managing Government: Financial Information

Every year, the federal government handles billions of dollars of taxpayers' money. Strong internal financial controls and complete financial information are vital if the government is to prudently manage its revenues and expenses. Gaps or weaknesses in financial controls can lead to inaccurate and unreliable financial information, poor control over physical assets, and improperly authorized financial transactions. Without good controls, an organization risks being unable to prevent or detect failures to comply with regulations, policies, and procedures.

In the 11 departments and agencies that account for most of the government's revenues and a large part of its expenses, we found progress in improving financial information to be unsatisfactory. With few exceptions, most financial information used in decision making continues to be based primarily on the cash method of accounting. This information provides a less complete and less accurate picture of an organization's financial situation than does information prepared by the accrual method.

Currently, the accrual method of accounting is used mainly at the end of the fiscal year to comply with requirements for preparing the government's summary financial statements. This is chiefly because departments and agencies make little use of accrual financial information as a regular management tool. Financial officials have indicated that departments and agencies will not use accrual financial information effectively until government-wide and departmental budgeting, financial reporting, and appropriations are done on a common basis.

Departments and agencies are slowly taking action to resolve the weaknesses we previously identified in their internal financial controls. In our view, however, until the government has addressed our concerns about the weaknesses that persist, the quality of financial information that departments and agencies use for many of their key decisions will be at risk.

Management of Programs for First Nations

Although the federal government spends billions of dollars a year on programs that address issues affecting First Nations—such as housing, health care, education, and economic development—conditions in many First Nations communities remain significantly below the national average.

Our follow-up audit examined the progress made by five federal organizations in implementing 37 recommendations from past chapters on First Nations issues. The chapters covered housing on reserves, economic development, health care, the food mail program, comprehensive land claims, and reporting requirements for First Nations.

Overall, progress in addressing our recommendations has been unsatisfactory. Although we recognize that the issues are highly complex, federal organizations had agreed with most of the recommendations and had committed to taking action. While we noted satisfactory progress in several areas, they are generally not the areas most important to the lives and well-being of First Nations communities. We found that little had been done, for example, to address the serious problem of mould in houses on reserves, to analyze patterns of prescription drug use and drug-related deaths, to implement comprehensive land claim agreements, to eliminate unnecessary reporting required of First Nations communities, and to address gaps in the Third Party Manager Policy.

During this audit, we identified several factors that appear to have been critical in successfully implementing our recommendations. Progress was more likely to have been satisfactory where programs were well-co-ordinated, received the sustained attention of management, and involved meaningful consultations with First Nations. In many cases, success was linked to the capacity of First Nations to carry out programs in their own communities and the presence of First Nations institutions that supported social and economic development in communities. Further, ensuring that programs and initiatives were based on appropriate legislation helped to clarify roles and responsibilities, and eligibility issues.

We noted that Indian and Northern Affairs Canada has different roles that create at least the appearance of conflict between its fiduciary responsibilities for First Nations and its obligations to act on behalf of the Crown, which has an impact on the implementation of our recommendations.

Acquisition of Leased Office Space

Public Works and Government Services Canada (PWGSC) is responsible for providing office accommodation to about 100 federal departments and agencies. The Department's real property business line has an annual business volume of about $3 billion and handles about 500 lease transactions a year. To manage this volume well, the Department needs complete, accurate, and timely information for decision making, strategic management, and risk management. Strong management practices are especially critical, given its commitment to reduce the costs of real property management by $1 billion over the next five years.

In 2002 we audited the Department's strategic planning, its risk management practices, and its analysis of options for providing office space. Our follow-up audit found that its progress since then has been unsatisfactory. There are still gaps in its financial and management information systems that pose significant risks to its $1 billion cost savings target. To achieve that target, the Department must manage its leasing projects strategically across the entire real estate portfolio. However, it will have difficulty doing that because the basic information that managers need to make critical strategic decisions does not exist, is inadequate, or is difficult to access.

The Department shares responsibility for decisions that affect the cost of office accommodation with client departments and the Treasury Board. Although it tries to identify the most cost-effective options for office space, client departments may decide on more expensive accommodations. It is difficult for PWGSC to enforce its standards for quality and quantity of office space, and this has resulted in added costs to taxpayers. In recommending the most cost-effective accommodation, the Department considers the cost of the lease over its life. However, the government's funding process focusses on annual cash spending. We found cases where the most cost-effective option could not be selected due to insufficient capital funding.

Canada Revenue Agency—Collection of Tax Debts

The vast majority of taxes and payroll deductions owed are paid on time. However, there is always a significant amount in taxes, interest, and penalties that the Canada Revenue Agency has assessed but not collected. This tax debt amounted to $18 billion at 31 March 2005. The Agency expects to collect about $13.3 billion of this amount; the rest is not likely to be collected because, for example, the taxpayer involved is insolvent. Any improvement in the Agency's ability to collect tax debts efficiently and within a reasonable length of time could add millions of dollars in revenues to the Crown every year.

We last audited this subject in 1994. In our follow-up this year, we found that the Agency had not made satisfactory progress in addressing recommendations aimed at improving the collection of tax debts. The Agency's approach to assessing files for risk continues to lack sophistication and has major weaknesses that impede the timely collection of tax debts. Further, the Agency still lacks important information needed to manage its collection of the tax debt effectively. However, it has made some significant changes to its collection systems and some of its practices, including updating the automated system that manages low-risk accounts, opening a national call centre, and establishing national pools to better manage workload. It has also improved the procedures to collect large tax debts.

Cash collected by collectors working at Tax Services Offices has increased since 1994 and now averages about $2.3 million for each collector. Yet despite this increase, the tax debt has grown at a faster rate than total taxes paid. At the same time, management is not collecting the data it needs to understand both why the amount of tax debt is growing and what it comprises.

The Agency has known for many years what it needs to do to improve the collection of tax debts but has been unable to achieve significant breakthroughs. It now has a strategic vision that sets a course for the future. The major challenge for the Agency is to turn that vision into reality through detailed planning, focussed management attention, and measurement of results.

Conclusion

Our audit work for this report generally confirms that programs and activities cannot be error-proofed by building a web of controls, rules, and regulations into their design to ward off risk. In fact, where the risks are weighed and managed, intelligent risk taking is vital to any innovative, successful organization. Programs that are mired in controls and reporting requirements are not programs that focus most of their efforts and resources on improving the lives of Canadians. In several of the areas discussed in this report, we see a need for the government to review whether programs have too many rules and whether their administration could be streamlined to improve delivery. In many respects, the government needs fewer rules, but rules that are consistently applied.