

2009



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

SPRING

Message from the Auditor General of Canada
Main Points—Chapters 1 to 6



Office of the Auditor General of Canada

The Spring 2009 Report of the Auditor General of Canada comprises a Message from the Auditor General of Canada and seven chapters. The main table of contents for the Report is found at the end of this publication.

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Ce document est également publié en français.

© Minister of Public Works and Government Services Canada 2009
Cat. No. FA1-2009/2-0E
ISBN 978-1-100-12459-9
ISSN 1701-5413



Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith this Spring Report of 2009 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*.

A handwritten signature in black ink that reads 'Sheila Fraser'.

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 12 May 2009

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**Message from the Auditor
General of Canada—
Spring 2009**

Message from the Auditor General— Spring 2009



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Sheila Fraser, FCA
Auditor General of Canada

This Report addresses several issues important to Canadians. A brief overview of the key issues in each chapter follows, but first I want to raise a matter that has implications for all of our audit work.

The government's approach to the documentation and availability of analysis is of growing concern to me. Most recently, this matter arose in our audit of gender-based analysis. We asked the central agencies to provide information that would demonstrate their review and challenge related to any gender-specific impacts of policy initiatives submitted by departments and agencies.

We were told by officials of central agencies—the Treasury Board of Canada Secretariat, the Privy Council Office, and the Department of Finance—that discussions had taken place concerning gender-specific impacts of proposed policy initiatives but that no record of these discussions existed, apart from what might be contained in confidential Cabinet documents that we are not entitled to see. This is not acceptable. Departments and central agencies must be able to demonstrate support for decision making by preparing and keeping relevant documents.

In its response to this audit, the government disagrees with our recommendation that central agencies document the challenge function they say is undertaken orally when reviewing spending initiatives and policy proposals going forward to Cabinet. It says this would be impractical, would not improve the challenge function, and would divert resources from the core function of providing the best and most relevant information to decision makers. In my view, however, documentation of relevant analysis is fundamental to the management process. Without it, government cannot demonstrate due diligence.

In its response, the government also claims that the final results of the challenge function are documented in advice to ministers, where appropriate. We respect the principle of Cabinet confidence. We do not need to see the advice and recommendations presented to ministers. However, the order-in-council that clarifies my access to key information was amended by the government in 2006; it clearly indicates that I may obtain the analyses performed by Treasury Board of Canada Secretariat officials from February 2006 onward. All of the initiatives included in our audit of gender-based analysis were undertaken after February 2006.

I strongly urge the government to ensure that relevant analysis is documented and maintained in information systems. Should the analysis not be available to me, I must conclude that it was not performed.

Gender-Based Analysis

Gender-based analysis is an analytical tool that can be used to assess how the impact that spending initiatives and policy proposals might have on women could differ from their impact on men. The federal government made a commitment in 1995 to implement gender-based analysis throughout its departments and agencies. Since then, a number of international organizations such as the Council of Europe, the United Nations, and the World Health Organization have emphasized that policy development in areas such as immigration, agriculture, and disease prevention need to reflect the differences in the obstacles and barriers that men and women face. Applying gender-based analysis to cardiovascular disease, for example, highlights the differences in risks, symptoms, and outcomes between women and men that need to be integrated in developing related policies and programs.

In April 2008, the House of Commons Standing Committee on the Status of Women requested that our Office examine the implementation of gender-based analysis in the federal government.

We found that despite the government's commitment to gender-based analysis, there is no government-wide policy requiring that departments and agencies perform it. Our examination of seven departments whose responsibilities can impact men and women differently shows a wide variety of practices. For example, while Indian and Northern Affairs Canada has implemented all key elements of a proper framework for gender-based analysis, Transport Canada and Veterans Affairs Canada have no framework.

We also found that very few of the departments that perform gender-based analysis can show that the analyses are used in designing public policy. In addition, their proposals to Cabinet and to the Treasury Board provided little information on how policies would specifically affect women and men. The 2007 revised Guide to Preparing Treasury Board Submissions reminds departments and agencies that they have to report such information. However, the new 2008 guide on drafting memoranda to Cabinet does not clarify how and when gender-specific impacts are to be considered and reported to Cabinet in policy proposals.

To enable the government to meet its commitment to gender-based analysis, we have recommended that Status of Women Canada, in consultation with the Treasury Board of Canada Secretariat and the Privy Council Office, clarify expectations, establish a plan for facilitating the implementation of gender-based analysis, and better communicate to departments and agencies what their responsibilities are in this area.

Intellectual Property

Intellectual property refers to legally protected rights resulting from intellectual activity in the industrial, scientific, literary, and artistic fields. Whether used for policy development, decision making, advancement of knowledge, or national security, intellectual property is a valuable asset that can help the federal government better serve the interests of Canadians. Managed well, intellectual property can lead to economic and social benefits and can contribute to Canadian innovation.

We found that the federal government does not know how much intellectual property it owns or how well it is being managed. Of the three science-based federal organizations we audited whose activities could be expected to generate intellectual property, two lacked adequate mechanisms and expertise to identify intellectual property—whether generated internally, as a result of their own activities, or externally in the course of contracted work.

Under government policy, when intellectual property is expected to result from a contract, the federal organization determines its ownership. With some specific exceptions, ownership is to go to the contractor in order to increase the potential for commercialization. We found that the Crown took ownership of the intellectual property in over half of all the contracts that we reviewed and, in many cases, without providing a rationale. We also found that Industry Canada and the Treasury Board of Canada Secretariat have not adequately monitored the application of the policy.

We found that there are significant errors in the government's data on intellectual property. If left uncorrected, these errors will undermine an evaluation, planned for 2011, of the policy on ownership of intellectual property resulting from contracted work.

Health and Safety in Federal Office Buildings

The federal government employs about 230,000 people who work in more than 1,400 buildings administered by Public Works and Government Services Canada (PWGSC) in all regions of the country. The government needs to adhere to policies and standards designed to protect the health and safety of employees. PWGSC is responsible for ensuring that the buildings it administers remain safe. Human Resources and Skills Development Canada (HRSDC), through its Labour Program, is responsible for administering and enforcing fire protection policy in these buildings, while individual departments have a responsibility for the health and safety of their employees.

We found that although departments are required to hold annual fire drills, they could not demonstrate that they were doing so in 33 percent of the buildings in our audit. Moreover, in almost all buildings where additional fire drills are required, departments were not holding them. We also found that for the majority of buildings in our audit, departments had not submitted fire safety plans to HRSDC's Labour Program as required by the Treasury Board Standard for Fire Safety Planning and Fire Emergency Organization. We noted that during our audit and in response to letters we sent departments indicating the serious nature of these deficiencies, the departments began to take corrective action.

HRSDC's Labour Program, for its part, has not established management systems to ensure that fire safety plans are reviewed and accepted for all federally occupied buildings. Nor can it demonstrate that it effectively administers the Standard for Fire Safety Planning and Fire Emergency Organization; it had reviewed the plans for only 19 of the 54 buildings in our audit and only 10 of those plans met the requirements and were accepted. We also found that the Labour Program lacks the information it needs to report on government-wide compliance with the Standard.

We found that while PWGSC has established clear internal policies and guidance for managing the condition and operations of the office buildings it administers, it could not demonstrate that its policies and guidance are consistently followed. Nor does it consistently correct all high-priority deficiencies it has identified in order to reduce risks to the health and safety of building occupants.

Interest on Advance Deposits from Corporate Taxpayers—Canada Revenue Agency

Through our annual financial audits of the Canada Revenue Agency, we found that a number of corporate taxpayers are maintaining large balances—totalling more than \$4 billion—on deposit with the Agency from year to year. Tax overpayments earned between five and seven percent interest during the past three years. We looked at whether the Agency adequately administers advance deposits under the *Income Tax Act* and regulations and at how it monitors and manages accounts where it might be obliged to pay interest.

We found that the Agency has known since 1991 that some corporations were depositing and leaving large balances in their accounts. At the time, the Agency questioned whether they were doing so to take advantage of the favourable interest rates. More recently, it concluded that most of the balances are refundable to the corporations, in many cases along with interest owing. When this occurs, the government will have paid interest at a higher rate than its own cost of borrowing. We conservatively estimate, based on a limited number of accounts, that the difference between the government's borrowing rate and the interest rates on these deposits represents a total of at least \$90 million in unnecessary interest costs over the past three years.

The Agency has attempted over the years to refund as many of these balances to the corporations as possible, but with limited success. It has not discussed this matter with the Department of Finance Canada, as it would normally do when it faces compliance challenges.

Financial Management and Control—National Defence

National Defence has an annual budget of almost \$19 billion and manages more than \$33 billion in equipment, inventory, and real estate. The financial decisions it makes have long-term impacts not only on the organization but on the safety and security of the nation. The Department's success in meeting its obligations under the government's defence policies hinges on its ability to manage its financial resources.

Our audits since the early 1990s have pointed to problems in financial management and controls at National Defence, and the Department itself has identified improving in this area as a priority. Our audit found that the Department has taken some steps in this direction. It has some basic elements of good financial control, including compliance with legislative and government requirements for financial reporting. It has kept its annual spending within authorized funding limits.

However, National Defence cannot demonstrate that its financial management systems and practices support resource management, corporate planning, and decision making, especially for the medium to long term. While the Department invests a lot of time in business planning, the result is a series of short-term operational plans for each division. There is no business plan that links defence strategy to objectives and the associated risks, activities, resources, and expected results. Such a plan is needed to guide decision making and resource management across the Department.

In addition, most of the systems that feed information into the Department's main financial system are not designed to support financial management. They are designed to support operational requirements. Furthermore, due to the lack of accurate and timely financial information for decision makers, the Department did not know until the end of the 2007–08 fiscal year that \$300 million of that year's funding was unspent and not available to be carried forward.

The Department does not yet integrate risk management in its planning and financial management activities. We could not find evidence that senior decision makers are routinely briefed on the status of key risks across the organization. As a result, they lack the information they need to plan and allocate resources for managing key risks to National Defence objectives.

Selected Contribution Agreements—Natural Resources Canada

Natural Resources Canada (NRCan) administers a number of contribution programs. The Department's internal audits of five contribution agreements found significant breaches of the agreements' terms and conditions; NRCan management brought the internal audit findings to our attention in August 2006.

We found a serious conflict of interest. The same consultant who provided services to the Department in relation to the contribution programs also worked for the organizations with whom the Department signed the five agreements. The consultant developed draft funding proposals that the organizations submitted to the Department, and he worked for them under contract after the agreements were signed. He also became president of one of the recipient organizations. NRCan was aware of these arrangements but did not consider them to represent a conflict of interest.

In our view, changes made by NRCan to address its internal audit findings on the management of contribution agreements are not adequate to prevent recurrences.

Special Examinations of Crown Corporations—2008

Parliamentarians have expressed an interest in knowing more about how Crown corporations operate. The last chapter in the Report is our second annual summary of the special examinations of Crown corporations that we completed in the previous year.

Between 31 March and 31 December 2008, we issued special examination reports on eight Crown corporations, the Main Points of which are included in the chapter:

- Canada Council for the Arts
- Defence Construction (1951) Limited
- The Federal Bridge Corporation Limited
- Great Lakes Pilotage Authority
- International Development Research Centre
- Pacific Pilotage Authority
- Parc Downsview Park Inc.
- VIA Rail Canada Inc.

We identified one or more significant deficiencies in three of the corporations:

- The Federal Bridge Corporation Limited had significant deficiencies related to securing funds and to oversight by the board.
- Great Lakes Pilotage Authority had a significant deficiency related to its operations.
- VIA Rail Canada Inc. had a significant deficiency in its ability to meet its strategic challenges.

We brought the significant deficiencies in all three corporations to the attention of the responsible ministers.

Until recently, Crown corporations were required to undergo a special examination at least once every five years. In early 2009, the *Budget Implementation Act* changed the reporting cycle to at least once every 10 years, a change that we fully support. Additional changes require that special examination reports be submitted to the appropriate minister and to the President of the Treasury Board 30 days after we provide them to the corporation's board of directors and that they be made public within 60 days.



Main Points—Chapters 1 to 6



Gender-Based Analysis

Chapter 1 Main Points

What we examined

Gender-based analysis (GBA) is an analytical tool that can be used to assess how the impact of policies and programs on women might differ from their impact on men. GBA is intended to allow for gender differences to be integrated in the policy analysis process. Coinciding with the United Nations' Fourth World Conference on Women in 1995, the federal government committed to implement gender-based analysis throughout its departments and agencies. Such analysis was to guide decision makers by informing them about any potential impact that policies, programs, or proposals might have on people because of their gender. Since then, the government has reiterated in a number of announcements that it intends to implement GBA. In April 2008, the House of Commons Standing Committee on the Status of Women recommended, in its ninth report, that our Office examine the implementation of gender-based analysis in the federal government.

Our audit looked at seven departments whose responsibilities can impact men and women differently—The Department of Finance Canada, Health Canada, Human Resources and Skills Development Canada (HRSDC), Indian and Northern Affairs Canada (INAC), the Department of Justice Canada, Transport Canada, and Veterans Affairs Canada. We examined whether they had established a framework to support GBA and had reported the results of their analyses in Treasury Board submissions and memoranda to Cabinet. We looked at 68 recent programs, policy initiatives, and acts of legislation developed in these seven departments to see whether they had undergone gender-based analysis. Our audit did not include verifying the data and research on gender impacts or challenging the conclusions of the analyses.

We also looked at the role played by the Treasury Board of Canada Secretariat, the Privy Council Office, and the Department of Finance Canada in challenging whether departments and agencies had identified potential gender impacts of proposals submitted for Cabinet approval. In addition, we examined the role played by Status of Women Canada in supporting the implementation of GBA in the federal government.

Why it's important

Gender-based analysis can contribute to attaining the overarching goal of gender equality. International organizations such as the Council of Europe, the United Nations, and the World Health Organization have emphasized that to have a positive impact on society, social policies and legislation in areas such as immigration, agriculture, and disease prevention need to reflect the differences in the obstacles and barriers faced by men and by women.

Failure to consider that men and women can be affected differently by similar situations can lead to policies that ignore the impacts on gender. For example, cardiovascular disease (CVD) is the number one killer of women. Because CVD has traditionally been considered a men's disease, research in the field has focused on middle-aged men, ignoring the fact that some women with heart disease might have different symptoms from those typically experienced by men. This could affect the drugs and the dosages prescribed to women. It could also lead women to ignore the symptoms of heart disease and wait too long to seek medical help.

What we found

- Despite the government commitment to GBA that has continued since 1995, there is no government-wide policy requiring that departments and agencies perform it. The existence and completeness of a GBA framework varied considerably among the departments we examined. For example, while INAC has implemented all key elements of an appropriate GBA framework, Transport Canada and Veterans Affairs Canada have no GBA framework.
- While some of the departments are making efforts to improve their GBA practices, few of those that are performing GBA can provide evidence that demonstrates these analyses are used in designing public policy. In 30 of the 68 initiatives we examined, gender impacts had been analyzed but there was no evidence that the analysis was considered in developing public policy options. In 8 initiatives, departments were able to demonstrate why GBA was not considered relevant. For 26 initiatives, we could find no evidence that gender impacts had been considered at all. Only in 4 initiatives was there evidence that GBA had been integrated in the policy development process.
- For the sampled initiatives, departments provided limited information to Cabinet and the Treasury Board on gender impacts of proposals. We found no reference to gender impacts in 15 of 28 memoranda to Cabinet and in 8 of 21 Treasury Board submissions. There was nothing to indicate whether those who submitted these had determined gender impacts to be irrelevant,

whether there was another reasonable explanation for the absence of this information, or whether gender impacts had ever been considered.

- The 2007 revised Guide to Preparing Treasury Board Submissions reminds departments and agencies that GBA information should be reported in submissions. The new 2008 guide on drafting memoranda to Cabinet has not clarified how and when gender impacts are to be considered and reported to Cabinet in policy proposals.
- While central agencies have all appointed GBA champions, they could not demonstrate that their analysts had reviewed and, when appropriate, challenged gender impacts of spending initiatives or policy proposals submitted by departments for approval. We noted that central agencies have made efforts to improve GBA training for the policy analysts responsible for challenging spending initiatives or policy proposals.

The central agencies and Status of Women Canada have responded. Detailed responses from the central agencies (Treasury Board of Canada Secretariat, the Privy Council Office, and the Department of Finance Canada) and Status of Women Canada follow each recommendation throughout the chapter. The central agencies disagree with our recommendations that they document their challenge of departmental gender-based analyses.



Intellectual Property

Chapter 2 Main Points

What we examined

Intellectual property includes rights resulting from intellectual activity in the industrial, scientific, literary, or artistic fields. This includes all intellectual creation legally protected through patents, copyright, industrial design, integrated circuit topography, and plant breeders' rights, or subject to protection under the law as trade secrets and confidential information. The federal government generates intellectual property as a component of activities carried out under federal contracts to procure goods and services. Intellectual property is also generated by the federal government through its own science and research activities.

Our audit looked at how intellectual property is managed in three federal science-based organizations—the National Research Council Canada, Health Canada, and Fisheries and Oceans Canada. We examined to what extent they comply with federal policy in managing intellectual property that arises in the course of contracted activities and how adequately they manage intellectual property generated by their own employees.

Our audit also looked at the roles of Industry Canada and the Treasury Board of Canada Secretariat in monitoring the application of the federal policy governing intellectual property that arises under Crown procurement contracts. In addition, we looked at the roles of the Treasury Board of Canada Secretariat and the Canada Public Service Agency in monitoring compliance with the Award Plan for Inventors and Innovators Policy.

Why it's important

Intellectual property is a valuable asset that can be bought, sold, licensed, lost, or stolen, and it should therefore be managed effectively. This includes knowing how and when to protect intellectual property. The National Research Council Canada, for example—by far the federal government's largest producer of inventions—spends more than \$1.6 million a year to protect the patents it holds, which produced \$5 million in revenue in the 2006–07 fiscal year. In calendar year 2006, billions of dollars in federal contracts were reported to contain some element of intellectual property.

Managed well, intellectual property can lead to economic and social benefits and contribute to Canada's innovation. Whether used for policy development, decision making, advancement of knowledge, or national security, intellectual property is a strategic asset that can help the federal government better serve the interests of Canadians. For example, the National Research Council Canada developed a vaccine for meningococcal disease that is currently being marketed in Canada and internationally. If intellectual property is managed poorly, however, the government could lose the ability to manage its intellectual property for the benefit of Canada. This includes losing the social benefits, such as improved health care, and the economic benefits, such as having more profitable companies.

The 2007 federal Science and Technology Strategy, *Mobilizing Science and Technology to Canada's Advantage*, recognizes that intellectual property is a critical component of the overall innovation system. The creation, development, and protection of intellectual property are critical early steps in the innovation process. Ongoing monitoring of the federal intellectual property regime is important to ensure that the intellectual property arising from federal investments in research translates into value for Canadians.

What we found

- Nearly 20 years after the federal government decentralized the management of intellectual property to federal entities, the mixture of legislation and policies governing it has resulted in a variety of management practices, some of which are inadequate. Neither Health Canada nor Fisheries and Oceans Canada has a department-wide policy, and both lack adequate mechanisms and expertise to consistently identify and disclose intellectual property generated by its employees. Despite their significant expenditures on science and technology, including millions of dollars in research and development, and the number of scientists and researchers they employ, there is very little disclosure of inventions developed by public servants in these two departments. The National Research Council Canada, however, has an entity-wide policy and adequately identifies its inventions by involving and training its researchers and officers at its institutes.
- The federal government is not in a position to know whether the objective of the eight-year-old Policy on Title to Intellectual Property Arising Under Crown Procurement Contracts is being met. It does not know how much intellectual property is generated externally in the course of contracted work. None of the entities we audited adequately identifies and reports whether work performed under contract is likely to generate intellectual property. The three science-based organizations we examined have not assessed whether the

Policy has been implemented and applied within their respective organizations. Although the Policy states that intellectual property should rest with the Crown only in exceptional cases, ownership was retained by the Crown in over half the contracts that we reviewed at Health Canada and Fisheries and Oceans Canada, often without clear justification. Industry Canada and the Treasury Board of Canada Secretariat have not adequately fulfilled their obligations to monitor the application of the Policy, with a focus on cases where exceptions were involved, and to evaluate the Policy.

- Since the introduction of the Award Plan for Inventors and Innovators Policy in 1993, the effectiveness of departmental and agency award plans and of the Policy itself have not been assessed. With the exception of one award in 1994, none of the entities we audited has distributed financial awards for the government use of inventions. With no assessment of the award plans and of the Policy itself, the federal government does not know if it has the appropriate financial incentives in place to encourage the commercialization of internally generated intellectual property or the use of inventions within the government.

The entities and the Secretariat have responded. The entities and the Secretariat agree with all of our recommendations. Their detailed responses follow each recommendation throughout the chapter.



Health and Safety in Federal Office Buildings

Chapter 3 Main Points

What we examined

Responsibility for ensuring the health and safety of federal employees working in a federally administered office building is shared among many parties. Public Works and Government Services Canada (PWGSC) is responsible for ensuring that federally occupied buildings, their operating systems, and equipment remain safe in accordance with applicable laws and regulations. Human Resources and Skills Development Canada (HRSDC), through its Labour Program, is responsible for administering and enforcing fire protection policy and standards in federally occupied buildings. In addition, individual departments have a responsibility for the health and safety of their employees working in those buildings.

We examined whether PWGSC manages the operation and maintenance of buildings under its administration in a way that effectively minimizes risks to the health and safety of building occupants.

We also assessed whether departments were planning for fire emergencies in compliance with key requirements of the Treasury Board Standard for Fire Safety Planning and Fire Emergency Organization (the Standard), including conducting required fire drills. In addition, we looked at the activities of Fire Protection Services (formerly called the Fire Commissioner of Canada), the division within HRSDC's Labour Program responsible for administering and enforcing this Standard. We also looked at the role of the Labour Program's regional and district offices in reviewing fire safety plans for buildings occupied by the federal government.

We looked at buildings administered by PWGSC to see whether the departments had adhered to the applicable policies and standards. Our audit focused on general-purpose office buildings administered by PWGSC and did not consider special-purpose buildings, the Parliamentary Precinct, or buildings administered by other government departments or agencies. We did not look at occupational health and safety programs of government departments. Our audit was not designed to assess the health and safety of a building, but rather to

examine the practices departments have in place to manage and mitigate risks to the health and safety of building occupants.

Why it's important

The federal government employs about 230,000 people in all regions of Canada who work in more than 1,400 buildings administered by PWGSC. In an organization of such magnitude, with high-rise buildings accommodating often thousands of workers, it is important that all established policies and standards are consistently adhered to. An overall culture of safety, promoted by management and including good building evacuation plans, fire evacuation drills, and properly maintained facilities, could greatly reduce the risks to the health and safety of employees. A sound framework for the maintenance and operation of buildings is critical to the health and safety of federal employees.

What we found

- Although departments are required to hold annual fire evacuation drills in order to train employees and test evacuation procedures, in 33 percent of the 54 buildings we looked at, departments could not demonstrate that they were doing so. Furthermore, the departments occupying almost all of the high buildings we reviewed are not carrying out the additional drills required. Departments do not comply with key requirements of the Standard for Fire Safety Planning and Fire Emergency Organization. For example, fire safety plans for the majority of buildings in our audit have not been submitted to HRSDC's Labour Program—the federal government's technical authority on fire safety—for review and acceptance. In response to concerns we raised during our audit about the lack of reviewed and approved fire safety plans and to letters we sent to departments drawing particular attention to non-compliance with fire drill requirements, departments began to take corrective action in order to address those deficiencies.
- HRSDC's Labour Program does not fully administer and enforce the Standard for Fire Safety Planning and Fire Emergency Organization. There is no government-wide monitoring of participation in fire evacuation drills. In addition, the Labour Program does not have adequate management systems in place to ensure that it reviews fire safety plans for all government buildings to determine whether they are adequate to evacuate employees in an emergency. The Labour Program had reviewed the plans for only 19 of the 54 buildings included in our audit (35 percent) and only 10 of these plans met the requirements of the Standard and were accepted.

- PWGSC has established clear internal policies and guidance for managing the condition and operation of office buildings under its administration. However, the Department could not demonstrate that established practices were followed consistently. We noted, for example, that in leased properties, PWGSC staff were not carrying out required building performance reviews in accordance with the Department's guidance.
- While PWGSC has a list of repairs and maintenance projects that it has identified to correct high-priority deficiencies, including those related to health and safety, it cannot demonstrate that the list is complete and accurate. Of the 280 projects on the list related to the 23 Crown-owned buildings we examined, 59 percent had been completed or substantially completed within the time frame required. Of the remaining projects, the Department deferred 12 percent and cancelled 4 percent; it was unable to provide sufficient documentation to demonstrate that another 4 percent had been completed or substantially completed. In addition, the Department has told us that, after further investigation during our audit, the remaining 21 percent of projects had been misclassified as high priority or included in the Building Management Plan in error. As a result, PWGSC cannot demonstrate that it is meeting its policy requirements to correct all high-priority deficiencies within the next fiscal year.

The departments and agencies have responded. All departments and agencies agree with our recommendations and have committed to implementing corrective action. In some cases, this action has already begun. Detailed responses can be found in the **Responses to Recommendations** section, starting on page 31.



Interest on Advance Deposits from Corporate Taxpayers—Canada Revenue Agency

Chapter 4 Main Points

What we examined

Corporate taxpayers who anticipate a reassessment of their income tax returns by the Canada Revenue Agency for a certain tax year may remit funds in advance, which the Agency will hold to apply when the reassessment is processed. Reassessments are fairly routine for corporate taxpayers, and the Agency asks that, when they make an advance deposit, they indicate the tax year to which the expected reassessment relates. For the majority of corporations, the amounts they deposit in advance are in line with the amount of tax they expect to be reassessed.

Our financial audits of the Agency noted that a number of corporations are maintaining large balances—totalling more than \$4 billion—on deposit with the Agency from year to year. Tax overpayments earned a rate of interest ranging between five percent and seven percent during the past three years. We decided to examine whether the Agency adequately administers advance deposits from corporate taxpayers under the *Income Tax Act* and *Income Tax Regulations* and whether it adequately monitors and manages accounts where it might be obliged to pay interest. We looked at the 50 largest accounts of corporate taxpayers, representing two thirds of the total balance on hand. Our review of these files went back three years.

Why it's important

The Canada Revenue Agency is responsible for administering Canada's tax system in a way that protects the tax revenue base. In our view, this would include ensuring that it does not make large interest payments that could be avoided and advising the Department of Finance Canada if it believes existing legislation is resulting in any unintended consequences.

What we found

- In 1991, the Agency recognized—soon after a change in the *Income Tax Regulations* raised the prescribed interest rate on overpayments to its present level—that certain corporations were depositing and leaving large balances on their accounts. It questioned whether they were doing it to take advantage of the favourable interest rates. More recently, when preparing the Agency's year-end audited financial statements, senior officials of the Agency concluded that most of the

balances are refundable to the corporations. In many cases, refunds will ultimately be made, along with interest that has accrued over the years. Where this proves to be the case, the government will, in effect, have paid interest at a higher rate than its own cost of borrowing. We conservatively estimate, based on a limited number of accounts, that the difference between the government's borrowing rate and the interest rates on these deposits represents at least \$30 million in unnecessary interest costs for each of the past three years.

- The Agency launched a number of initiatives over the years to refund as many of these balances as possible, but with limited success. If a corporation did not choose to withdraw its balance, the Agency accepted the decision. Officials told us that in the absence of voluntary cooperation by the taxpayer, the Agency held the balance in the taxpayer's account. Although it normally informs the Department of Finance Canada of any compliance challenges that could signal the need for legislative change, the Agency has not discussed this matter with the Department of Finance Canada or proposed any solutions to reduce interest costs. We note that other jurisdictions limit the interest payable in similar situations.
- As tax legislation is silent on whether the Agency can accept or refund advance deposits, the Agency developed an administrative practice. This practice was designed to allow corporations to minimize interest costs where there is a bona fide risk of reassessment. However, the Agency is not currently requiring corporations to follow guidance it has published in its Corporation Instalment Guide, and key aspects of the Agency's practices for managing advance deposits remain unclear. For example, corporations frequently do not identify the tax year to which their advance deposits relate. Moreover, although the guide discusses accepting payments only in the context of "anticipated reassessments," the Agency does not have a process in place for checking its own files to see if a reassessment is in the works and if the amount deposited is in line with the amount likely to be reassessed.

The Agency has responded. The Agency agrees with our recommendation. Its detailed response follows the recommendation in the chapter.



Financial Management and Control— National Defence

Chapter 5 Main Points

What we examined

Effective financial management means having the financial and risk information an organization needs to make sound decisions in planning, delivering, monitoring, and evaluating its programs and activities. It is a critical part of managing that helps an organization assess the cost of achieving its objectives and contributes to managing its risks. Relevant financial information and control systems are essential to ensuring that managers have access to sound, up-to-date financial information for decision making.

National Defence has an annual budget of almost \$19 billion and manages over \$33 billion in equipment, inventory, and real estate. Over the past few years, the Department has experienced real growth in funding—a trend that is projected to continue. Our audit examined whether National Defence’s financial management practices support financial decision making, resource management, planning, and management of risks. We focused on the activities of the senior managers who are responsible for deciding how the Department’s funding will be allocated and what major investments the Department will make.

Why it’s important

With annual total spending in the billions of dollars and operations around the world, National Defence is one of the largest government departments. The Department’s financial decisions have long-term impacts not only on the organization, but also on the safety and security of the nation. The Department’s success in meeting its obligations under the government’s defence policies hinges on its ability to manage its financial resources. A decision made one year—for example, to invest in major equipment with prolonged delivery schedules and an extensive useful life—can have financial implications for many years ahead. Good financial management is especially important given that the Department is allowed to carry forward surplus funds currently equivalent to only 1 percent of its funding, compared with the 5 percent allowed most other departments. Although its budget and carry-forward is large in real terms, National Defence must manage financially within tighter parameters.

National Defence has identified financial management as a priority for many years. Audits by our Office since the early 1990s have also identified financial management and controls as areas that need attention in the Department.

What we found

- National Defence has taken steps to strengthen financial management and control. It has some basic elements of good financial control, including compliance with legislative and government requirements for financial reporting, and it has kept its annual spending within authorized funding limits. However, National Defence's governance structure is not sufficiently focused on financial management. We also noted that the Department's draft governance framework does not mention the responsibilities and accountabilities of the Chief Financial Officer, a position required under the Treasury Board of Canada's new Policy on Financial Management Governance.
- National Defence invests a lot of time in business planning, but the result is a series of short-term operational plans for each division. There is no corporate business plan that links defence strategy to objectives and associated risks, activities, resources, and expected results with medium- and long-term plans in order to guide decision making and resource management across the Department.
- The Department's financial management and monitoring of resources may not be adequate to support decision making by senior management. The lack of accurate and timely information for decision makers contributed to the lapsing of more than \$300 million in funding that was available during the 2007–08 fiscal year but is now permanently unavailable to National Defence.
- The Department is aware of the need to manage the risks associated with its responsibilities. However, its integrated risk management framework has not yet been incorporated in the analysis, recommendations, and reports used by senior management. Consequently, senior management lack the information needed to plan for and allocate resources to manage key risks that could impact National Defence in meeting its objectives.

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



Selected Contribution Agreements— Natural Resources Canada

Chapter 6 Main Points

What we examined

Natural Resources Canada (NRCan) seeks to enhance the responsible development and use of Canada's natural resources and the competitiveness of Canada's natural resources products. It devotes a significant portion of its budget to grants and contributions, some of which are administered by its Office of Energy Efficiency. In fiscal year 2007–08, NRCan's voted grants and contributions accounted for over \$211 million, of which \$28 million or 13 percent was in the Office of Energy Efficiency program area.

Between April 2003 and March 2005, NRCan's Office of Energy Efficiency entered into five contribution agreements with three private sector organizations to deliver programs designed to address greenhouse gas emissions in the transportation sector. The total amount disbursed under the five agreements was about \$5.9 million.

At the request of NRCan senior management, the Department's internal auditors carried out audits of the five agreements. The audits identified material breaches of the terms and conditions of the contribution agreements, which NRCan brought to our attention in August 2006.

We examined NRCan's actions in entering into and managing these five contribution agreements and also considered whether controls the Department now has in place would be adequate to prevent recurrences of the matters identified in the Office of Energy Efficiency program area.

Our conclusions relate only to the management practices and actions of public servants. The policies and requirements to which we refer apply only to public servants and not to private sector consultants or organizations. We did not audit the records of private sector consultants or organizations. Consequently, our conclusions cannot and do not pertain to any practices that private sector consultants or organizations followed or to their performance.

Why it's important

The government has many ways to pursue public policy objectives, including transfer payments to individuals, organizations, and other levels of government. Contributions are transfer payments that are subject to performance conditions specified in a contribution agreement with the recipient. The recipient must show that it is meeting the performance conditions in order to be reimbursed for specific costs over the life of the agreement. The government can audit the recipient's compliance with the performance conditions.

The terms and conditions specified in a contribution agreement detail the government's expectations of the recipient of the funds. It is important for government to establish compliance with these terms and conditions in order to ensure that it is achieving the intended results of the agreement. Similarly, an essential control over the expenditure of public money is contained in section 34 of the *Financial Administration Act*, which requires certification that amounts are paid in accordance with the terms and conditions of an agreement.

It is important that government business be conducted openly and fairly, and that conflicts of interest, in fact and in appearance, be avoided.

What we found

- Before signing the five contribution agreements, NRCan knew that a consultant who had provided services to the Department relating to the contribution programs would also be working for the organizations that received NRCan funding under these programs. In our view, this is a conflict of interest that NRCan did not identify.
- Payments totalling about \$3.2 million that NRCan made under the contribution agreement with CEEA Transport were not in accordance with the terms and conditions of the agreement. Similarly, payments to the Canadian Energy Efficiency Alliance and the Canadian Natural Gas Vehicle Alliance were not in accordance with the terms and conditions of their contribution agreements. The Department also did not satisfy its obligation under section 34 of the *Financial Administration Act*, which, in the case of a contribution agreement, requires certification that amounts are paid in accordance with the terms and conditions of the agreement.
- In response to the findings of its internal audits, NRCan has since implemented a number of changes and improvements in its management practices for contribution agreements. However, the practices still do not include adequate independent monitoring to ensure that the management of contribution agreements respects the requirements of the *Financial Administration Act*, the Treasury

Board of Canada Policy on Transfer Payments, and the Department's own policy and practices governing contribution agreements. Nor has the Department developed policies and guidance on conflict of interest in contribution agreements to prevent recurrences.

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

Report of the Auditor General of Canada to the House of Commons—Spring 2009

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