

Report of the Auditor General to the House of Commons for the Fiscal Year Ended March 31, 1978

Introduction

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act, 1976-77, c. 34, which came into force August 1, 1977. His responsibilities in respect to those Crown corporations for which he has been appointed auditor are set out in Sections 76 to 78 of the Financial Administration Act, R.S., c. F-10. The Auditor General Act is included as Appendix A to this Report and the relevant sections of the Financial Administration Act as Appendix B.

In compliance with Section 7 of the Auditor General Act, my Report for the fiscal year ended March 31, 1978, is presented herewith.

My examination included general reviews of the accounting procedures and such tests of accounting records and other supporting evidence as were considered necessary in the circumstances. My staff was provided with all the information and explanations required. I should like to express my appreciation and that of my associates in the Audit Office for the co-operation extended to us by officials of departments, agencies and Crown corporations.

The financial statements of the Government of Canada for the fiscal year ended March 31, 1978, which have been prepared by the Receiver General for Canada in accordance with the provisions of Section 55 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by Section 6 of the Auditor General Act. These statements and my opinion thereon are reproduced in Appendix C of this Report.

My staff has reviewed the findings, observations and recommendations contained in this Report with the appropriate government officials and I have discussed the key issues of government-wide significance with the President of the Treasury Board, the Comptroller General and the Secretary of the Treasury Board. Reproduced on the following pages is the complete text of a letter dated October 13, 1978, from the President of the Treasury Board, the Honourable Robert Andras, P.C., M.P., in which he provides a formal response to the key government-wide issues. My reply to Mr. Andras dated October 17, 1978, is reproduced following his letter.

October 13, 1978

Mr. J.J. Macdonell,

Auditor General of Canada,

240 Sparks Street,

Ottawa, Ontario.

KIA 0G6

Dear Mr. Macdonell:

I would like to summarize, for publication in your 1978 Report to Parliament, my formal response to the information which you have imparted to my senior officials and myself concerning your forthcoming audit findings and observations.

Primarily, our discussions have centered on the opinions which you have formed as a direct result of the "Study of Procedures in Cost Effectiveness" (SPICE), which your Office conducted over the past two years in Departments and Agencies of the federal public service. There have also been discussions of your views on the future quality and coverage of the internal audit function in Departments and Agencies.

In view of the likely significance of your observations to Parliament, I welcome this opportunity to outline some of the major initiatives relevant to your findings which have already been taken by both the Treasury Board Secretariat and the new Office of the Comptroller General.

With the full support and approval of the Treasury Board Ministers the Comptroller General, in close cooperation with the heads of major Departments and Agencies, has commenced a comprehensive review of their financial administrative and control activities. The twenty Departments which have been selected for the initial review, utilize the major portion (70%) of current budgetary expenditures. The second phase of this review will cover the balance of the organizations which form the Government of Canada's accounting entity.

The scope of this review has been extended to include the operational planning and control activities which I know you agree are so basic to the exercise of good financial control. In this connection, a careful examination will be made of the extent and quality of performance measurement and program evaluation activities carried out by Departments and Agencies in response to Treasury Board directives and guidelines issued in 1976 and 1977.

The purpose of these reviews is to establish agreement, with each Department, on the specific actions which are considered appropriate to accomplish improvements across the spectrum of financial administrative and related operational planning and control practices, wherever the need for such improvements is identified. Such agreements on actions will then be reflected in appropriate plans and timetables for the execution of the necessary work.

In the area of the practices and procedures used for the measurement of efficiency and effectiveness, which has been a major focus of the SPICE Study conducted by

your Office, the reviews will result in the establishment of plans with each Department that will provide a detailed understanding for the ultimate extension of such procedures to all those operations and programs of Government where they may appropriately and reasonably be applied. The priorities for this work will be established by application of the following four criteria:

- (1) importance in terms of departmental or ministerial priorities;
- (2) the relative ease of conducting the evaluations, - the easiest programs will be evaluated first;
- (3) the size of the program, - larger value ones will be considered first; and
- (4) the expected cost of the evaluation in relation to the size of the program.

These plans and their timetables, when completed, will be made available to you, and thus to Parliament, as evidence of actions that are responsive to the type of problems in economy, efficiency and effectiveness evaluations that will be identified in your Report. In accordance with the Comptroller General's mandate and responsibility for the further development and maintenance of existing Treasury Board policies and directives in this complex area, his Office will also use these plans and timetables to monitor the improvements that will be accomplished by Departments and Agencies over time.

These reviews will also enable the Treasury Board to approve plans established within each Department for the development of their internal audit capabilities. This planning process will begin in the 1979-80 fiscal year. Such plans will not be restricted solely to the development of internal financial audit capability, but will also include the internal audit coverage of other equally important management functions such as "operational" or "managerial" audit activities and of course, departmental adherence to all Treasury Board policies and guidelines. The adequacy of the total internal audit function will be assessed in terms of its scope, the appropriateness of skills and staff resources available, the professional conduct of such staff, the independence of the audit function and the priorities established in internal audit work programs by Departments. Such plans will be made available to your Office, in the knowledge that they will be of assistance to you in the future planning and scheduling of your audit activities.

On the particular issue of the planning of capital acquisitions, which is another aspect of the SPICE examination, in July 1978 the Treasury Board issued a new policy and guidelines on the management of major crown projects. The essence of this important document will be reiterated in a forthcoming Treasury Board Circular covering the approval of all capital projects. I have also instructed the Treasury Board Secretariat to prepare guidelines on the selection and remuneration of qualified project leaders for major crown projects for further consideration by Treasury Board.

I have noted carefully your comments concerning the desirability of establishing "departmental comptrollers". As you know, I have supported this concept in the past. The task now is to evolve towards such an organizational form and to develop it, so that it may accommodate the particular needs of individual Departments and Agencies.

Your discussions have covered a variety of other topics which will be the subject of observations in your forthcoming Report. I would like to comment briefly on the important government-wide issues of the future form of the Estimates, and your comments on the desirability of charging Departments for the accommodation that they occupy.

With respect to the future form of the Estimates, we have discussed the major study of this matter that has been undertaken by the Treasury Board Secretariat. The first objective of this study is to provide an improved communication to Parliament of government expenditure plans and the necessary parliamentary authorities needed for their execution. The second objective is to improve the linkage between the Estimates and the operational plans of program managers. To achieve both objectives satisfactorily is clearly a complex task. Because of this, the study team has been instructed to conduct a comprehensive review of the issue taking into account the views and advice of all major users of the Estimates. The work which has been undertaken by your Office and the reactions of the parliamentarians to the options which you will display to them will therefore be of great assistance to both the study team and the Government in the formulation of its proposals to Parliament on this important issue.

The question of accommodation charges was the subject of intense study by the Executive during 1974 and 1975 and a decision was taken at that time not to implement any internal charging system for accommodation occupied by Departments and Agencies. Instead, it was decided that an improved display of accommodation costs in the Estimates and accounts of both the Department of Public Works and user Departments would improve the control and accountability for accommodation services. Your current comments however, taken in conjunction with those of the Standing Committee on National Finance have led me to request a review of the basis for that decision.

In conclusion, I trust that you will agree that these plans which I have briefly summarized are the most suitable way to effect improvements in the financial and related operational control practices of the federal public service, an objective which I can assure you is fully supported by both the Executive and the operating Departments and Agencies which serve it.

Yours sincerely,

Robert Andras.

240 Sparks Street,

KIA 0G6

October 17, 1978

The Honourable Robert Andras, P.C., M.P.,

President of the Treasury Board,

House of Commons,

Ottawa, Ontario.

Dear Mr. Andras,

Your letter of October 13 is a constructive and welcome response to the government-wide observations and recommendations that my current annual Report brings to the attention of Parliament.

As you and your officials know, the main thrust of most of the government-wide and departmental observations and recommendations in my 1978 Report is to promote a greater sense of awareness and accountability for the economical, efficient and effective use and management of public funds and resources. In your letter, you refer particularly to our Study of Procedures in Cost Effectiveness which has become known by the acronym SPICE. Through this government-wide study, which has generated a remarkable degree of interest on the part of many officials, my Office has introduced systematic value-for-money (VFM) auditing of government expenditures on behalf of Parliament as required by the new Auditor General Act proclaimed last year. As the results of our early SPICE studies began to accumulate and give added weight to findings arising from our regular audit programs and our other special government-wide studies conducted during the last several years, I became more and more concerned - and troubled - by the mounting evidence of a widespread lack of due regard to economy and efficiency and of insufficient attention to systematic, well-founded evaluations of program effectiveness.

It was clear that in many departments the functional and technical support given to deputy heads and program managers was inadequate for enabling them to discharge satisfactorily their resource management responsibilities. It was equally apparent that most deputy heads were not really aware of this serious situation and that they saw effective resource management as having much lower priority than their other key responsibilities. The programs described in your letter address these fundamental issues directly. They should ultimately redress the situation if pursued with vigour and appropriate resources and if given continued, demonstrable support by the Government and a supportive and cooperative response by senior officials and managers at all levels.

I am confident that such responses will be forthcoming in good measure, based on the keenly interested and constructive attitude displayed in a series of meetings that I held in May 1978 with groups of deputy heads to acquaint them firsthand with the results of our value-for-money audits and other special examinations this year, including our analysis of internal audit/evaluation/review capabilities. Most of the discussions centred around our more important

recommendations and the actions that deputy heads could initiate reasonably promptly to remedy the deficiencies our studies revealed. It was clear that our findings were of concern to these top officials and particularly so at a time of economic stress when significant reductions in government expenditures were in prospect. Their concerned and supportive attitude has already been demonstrated in a number of instances by significant actions to strengthen resource management.

In my 1975 Report, I was highly critical of the quality of internal financial auditing throughout government. Because little had been done in most departments to improve the situation, this year we conducted a government-wide review of internal auditing - both financial and operational - to find out whether good value was being obtained for the money expended. Preliminary results confirmed that a multiplicity of audits and evaluations were being conducted for various purposes by various agencies and that they were largely uncoordinated and in many cases ineffective. Many departmental managers felt that little or no apparent benefit resulted from these audits and begrudged the substantial amounts of their time spent coping with inquiries from a plethora of auditors. Clearly the total government audit/evaluation/review effort could not be really cost effective or supportive of management until it was properly integrated, coordinated and upgraded.

I conveyed these findings (described in Chapter 12 of my Report entitled Comprehensive Internal Auditing Within Government - A Recommended Approach) to the deputy heads at our meetings in May and stressed that this major recommended reform to improve resource management could be implemented within their own authority and largely within their own resources. The results to date have been encouraging. For example, some departments have established audit committees under the chairmanship of the deputy head and have consolidated the departmental internal audit/evaluation/review activities under one senior official responsible directly to the deputy head. As you know, the Secretary of the Treasury Board and the Comptroller General have taken similar steps to integrate and coordinate audit and evaluation activities conducted by the Treasury Board.

I have cited the foregoing in some detail because our recommendations on internal audit/evaluation/review can be implemented reasonably quickly and, in quite a few cases, without a need for any significant additional resources. Your indicated support of departmental initiatives to enhance resource management effectiveness, and the approval of the Treasury Board of plans to implement them, will add momentum to the overall reform program to which your letter refers.

A start has already been made on another important aspect of the overall program - the designation of appropriately qualified Departmental Comptrollers - to which you initially gave your support in the House of Commons on December 9, 1976. As stated in your letter, the task now is to evolve towards such an organizational form and to develop it to accommodate the particular needs of individual departments and agencies. The recognition of this function and its staffing by highly qualified and experienced persons is a key element in the continued progress towards an effective financial management and control system to which you and your ministerial colleagues are dedicated.

Other more complex aspects of the reform program admittedly will require time to accomplish. These include the comprehensive review of the financial administrative and control activities of departments and agencies which has been launched by the Comptroller General, the development of more meaningful financial information for Parliament, the improvement of

the linkage between the Estimates and the operational plans of program managers, and other substantive matters in my 1978 Report and referred to in your letter of October 13. But the support of the Government and Parliament to the objectives of these reforms and to improvements in financial and related operational control practices of the federal public service should ensure their ultimate attainment.

Following the established practice of the past several years and in response to the stated request of the Standing Committee on Public Accounts, I shall continue to follow closely the various aspects of the programs to implement recommended changes which have been agreed on and will be reporting on their progress in future reports to the House of Commons. In this connection, your letter of October 13 setting out the Government's position and plans with regard to the more significant recommendations will be particularly helpful. I appreciate very much your precedent-setting action in making it available to me for inclusion in the Centennial Annual Report of the Auditor General to the House of Commons.

Yours sincerely,

J.J. Macdonell

Auditor General of Canada

1978 Report of the Auditor General of Canada - Chapter 1

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Matters of Special Importance and Interest</H1>

</CENTER>

<HR>

As the seventh Auditor General of Canada since the office was established in 1878, I am privileged to present this 100th annual Report to the House of Commons.

1.1 Recent Reports presented the results of the Financial Management and Control Study (1974-76) and the Computer and Information Systems Evaluation (1976-77), which together produced more than 60 significant recommendations of a government-wide nature and hundreds of recommendations at the level of departments and Crown corporations. The most important of these recommendations was implemented on April 2, 1978, by the appointment of the Comptroller General of Canada.

1.2 From the standpoint of the accountability of public servants to the Government and of the Government to Parliament, however, I consider that the findings and recommendations of the Study of Procedures in Cost Effectiveness (SPICE) conducted during the last 18 months are as important as any I have reported to Parliament during my term of office and may well be as important as any reported to Parliament since the Audit Office was established one hundred years ago. This first reporting on value-for-money auditing is contained in this centennial Report which also:

- introduces a plan for cyclically programmed comprehensive auditing on behalf of Parliament;
- offers a key recommendation that the Government introduce comprehensive internal auditing incorporating economy, efficiency and program effectiveness evaluations in all departments;
- illustrates ways in which better financial information can be presented to Parliament; and
- presents observations and recommendations arising from other special reviews and regular audit examinations.

1.3 I am concerned and troubled by the cumulative effect of what my staff has observed in regular audit programs and in the special major government-wide studies during the last several years, capped by the SPICE project, which causes me to report to Parliament in accordance with the requirements of the new Auditor General Act that:

There is, in my opinion, widespread lack of due regard for economy and efficiency in the operations of the Government, and inadequate attention to determining whether programs costing many millions of dollars are accomplishing what Parliament intended.

1.4 It may seem somewhat venturesome to provide Parliament with an opinion on an organization as large and complex as the Government of Canada based on departmental studies, however carefully conducted, many of which involved essentially new methodology for the Audit Office. However, the findings described in Parts 1 and 2 of this Report, resulting from the work of our regular audit staff and of the team of more than 50 senior and experienced representatives of the Office drawn from inside and outside the public service who carried out our first organized and systematic value-for-money audits during some 18 months, lead clearly to this opinion. It is in line with the observations derived from our general audit work and special studies throughout the Government during the last several years.

Study of Procedures in Cost Effectiveness

Introduction

1.5 The Study of Procedures in Cost Effectiveness (SPICE), begun in 1976, reflects the evolution of auditing from a mainly accounting focus to a broader mandate encompassing questions of "value for money". Under Section 7(2) of the Auditor General Act, the Auditor General is required to report to Parliament cases where he has observed that:

"(d) money has been expended without due regard to economy or efficiency; or
(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented".

We addressed these responsibilities through SPICE, a special project organized within the Office to develop methodology and prepare the first report under the value-for-money mandate.

1.6 In each of 23 departments, SPICE teams raised questions about management's attention to economy, efficiency and effectiveness. As a result of our first departmental examinations, we identified several general areas of management control for further study. We investigated three of these general areas in some detail and have included the significant issues in Chapters 3 to 5 of this Report. Investigations of other management areas are proceeding. As further significant issues emerge, we shall include them in future annual Reports.

An Overview

1.7 *Based on 35 studies of selected aspects of management in 23 departments, our audits disclosed significant weaknesses in the development and use of information needed to achieve economy, efficiency and effectiveness in federal public administration.*

1.8 The studies which form the basis for this conclusion have been summarized in interim reports and discussed at length with departmental program managers and deputy heads. For the most part, they responded promptly, positively and constructively. They initiated many improvements, in some cases almost at once and in others after we completed our audit.

1.9 Three aspects of management have been investigated in sufficient detail to report government-wide findings -- planning capital acquisition projects, measuring and increasing efficiency, and evaluating effectiveness.

Planning Capital Acquisition Projects (Chapter 3)

1.10 Within the broad scope of "planning", we concentrated on projects involving the acquisition of capital assets such as airport terminals, office buildings and major items of equipment. The SPICE project examined a series of capital projects with final costs estimated at about \$700 million. By comparison, total approved capital cost for all projects under way in 1977-78 is estimated at \$10,000 million.

1.11 *Based on 13 SPICE audits completed to date, the capital acquisition process does not come up to a reasonable standard of "due regard for economy". The process suffers from a number of shortcomings which in total indicate that resources of an appropriate quality were not acquired at a minimum cost.*

1.12 *Our findings are not uniform across all projects examined. Deficiencies that affected one project may not have appeared in another. Two of the 13 projects demonstrated reasonable regard for economy.*

1.13 Our audits indicate that by and large a reasonable process was not followed in planning and carrying out capital projects. In previous Reports, I commented on the natural tendency for a program manager to advocate proposals for new initiatives in response to incentives that encourage larger and more costly projects and programs. Under these circumstances it is not surprising that there have been major expenditures on capital projects that might not have been authorized or might have been authorized only on a reduced scale had a reasonable planning process been followed. The absence of appropriate controls calls in question not only the \$10,000 million capital cost of current projects but also operating and maintenance commitments that stretch decades into the future. The Treasury Board's recently issued Policy and Guidelines on the Management of Major Crown Projects is a partial response that should be strengthened. More important, however, is the need for a change of attitudes. Ministers should always be presented with a balanced assessment of reasonable alternatives, never with a brief advocating one course of action.

Measuring and Increasing Efficiency (Chapter 4)

1.14 The review of the quality and usefulness of performance measurement systems has concentrated on the productivity of people in labour-intensive operations. We reviewed controls over efficiency in each program examined and some audits have concentrated primarily on this question.

1.15 *The Treasury Board Secretariat has provided leadership in defining the issues surrounding performance measurement. Through its directives and compliance reviews, the Treasury Board has indicated the importance it attaches to this basic management responsibility.*

1.16 *Our examination of 16 performance measurement systems covering about 100,000 man-years in 12 departments revealed only two systems that were considered satisfactory. Most of the performance measurement systems reviewed did not play an important part in the program management process. They generally did not satisfy the information needs of the operating manager who must make the day-to-day decisions required to control productivity.*

1.17 *In most operations we audited, management did not know the actual level of efficiency or how much it might be increased. In most labour-intensive situations, there was insufficient effort to increase productivity.*

1.18 I am impressed by the Treasury Board's evident concern since 1970 for the issues involved in performance measurement. The Board issued two major directives on this matter. As a result, thousands of valuable man-hours of highly skilled people have been invested in systems to monitor performance. By and large, these systems are not used. Management apparently is not sufficiently concerned to ensure appropriate design and update of systems as circumstances change. Where reasonable information has been available, it generally has not contributed to the management process.

1.19 This situation represents waste of major proportions, first in the investment of scarce specialized resources in developing systems, and second in the cost of operating systems that are not useful or not used. Neither operating management nor the staff of my Office know the actual level of productivity or even whether productivity is improving or deteriorating. Also of concern to me is the evidence that the intentions of the Treasury Board have been blunted. The response to its initiatives, rather than increasing productivity, may have led to a net waste of resources.

Evaluating Effectiveness (Chapter 5)

1.20 Evaluation of the extent to which a program achieves its objectives -- the effectiveness question -- is receiving increasing emphasis in public sector management. A period of budgetary restraint calls for thorough application of evaluative procedures. It becomes even more urgent when one considers the propensity of public programs to become self-perpetuating.

1.21 *A review of 23 programs in 18 departments has disclosed few successful attempts to evaluate the effectiveness of programs. The scope and quality of effectiveness evaluation will have to be increased significantly before management, the Government and Parliament, each with its respective interests, can be reasonably informed on the achievements of public programs.*

1.22 I have observed a mystique that surrounds the question of evaluating program outcomes. Many see program evaluation as complex, esoteric and difficult, if not impossible. In plain language, we are talking about the information managers should have at their fingertips concerning the accomplishments of government programs. By and large, the Government does not have this information, even though it is basic to the concept of accountability.

1.23 There is an understandable temptation to avoid any attempts to evaluate effectiveness because the evaluation may reveal findings unfavourable to a program. Any attempt to evaluate effectiveness in the government environment is an act of courage. Those who have made the attempt should be applauded. Unfortunately, not all attempts to measure program effectiveness have been successful. My staff has identified weaknesses in some of the studies which have been undertaken. Nevertheless, these criticisms are minor in comparison to those that should be levelled at managers who have made no serious attempt to measure the effectiveness of their programs.

Organization and Background of the SPICE Project

1.24 Since January 1977, when value-for-money audits began, more than 100,000 professional hours have been devoted to the SPICE project under the direction of Kenneth G. Belbeck, President of the Canadian management consulting firm of Stevenson & Kellogg, whose services were made available to my Office for a period of two years under the Executive Interchange Program of the Public Service Commission. Assisting him in directing the study have been a senior associate from his firm also on loan under a two-year Executive Interchange agreement, an Assistant Auditor General, three principals of our Office and a number of partners of management consulting and public accounting firms. For over two years Rheal Chatelain, Deputy Auditor General, and I have devoted a considerable amount of our time to this project and have reviewed carefully the findings, conclusions and recommendations. We have also benefited from consultation with an Advisory Committee comprising the managing partners of four other leading Canadian management consulting firms under the chairmanship of Mr. Belbeck. In short, the findings, conclusions and recommendations of the SPICE project are firmly based.

1.25 In one sense, value-for-money auditing is not new to the Audit Office. Auditors General in Canada, in the United Kingdom and elsewhere have long recognized that their responsibilities to the legislative bodies to which they report extend beyond attesting to the precise, letter-of-the-law compliance with financial authority. They have often reported examples of waste, extravagance, and abuse of trust in the handling of public funds which came to their attention during financial authority compliance audits.

1.26 Formal recognition of the need for value-for-money auditing in Canada resulted from the work of the Independent Review Committee on the Office of the Auditor General of Canada appointed in October 1973. The Committee, chaired by the late J.R.M. Wilson, F.C.A., inquired into the responsibilities of the Office of the Auditor General, its relationships with government departments and agencies and its reporting procedures. It considered the "statutory and other requirements to ensure that he can meet such responsibilities with the necessary degree of independence". The Committee drew on its own experience, on its investigations in Canada and on experience in other countries. Focusing on the relationship between the fundamental concepts of accountability and audit, the Committee noted in its report of March 27, 1975, that government auditors should advise legislatures whether funds they grant to the administrative arms of government have been properly used. It construed this audit responsibility broadly, proposing a place in it for value-for-money auditing as part of a far-ranging set of recommendations on the work of the Audit Office.

1.27 In the summer of 1976, I was informed of the Government's intention to introduce a Bill, based on the recommendations of the Wilson Committee, to broaden the audit scope and strengthen the independence of my Office. The Bill would include the responsibility of reporting to Parliament on economy, efficiency and effectiveness. I immediately began the development of resources to prepare the Office for these new responsibilities. In January 1977 we launched the Study of Procedures in Cost Effectiveness with the following objectives:

- to compile information on the "state of the art" of management control systems in the public sector, in terms of economy, efficiency and effectiveness;
- to assess and report on existing procedures for planning, measuring and controlling activities in Canada's public service (in the interests of economy, efficiency and effectiveness); and

- to recommend to the Office of the Auditor General how this new mandate should be exercised in the future.

1.28 By August 31, 1978, we had launched 52 value-for-money audit projects in 30 departments. Thirty-five had been completed and interim reports released to departments for verification of factual accuracy, for comment and for response. Work on the remaining 17 projects is being integrated with our continuing audits of government departments. As noted earlier, more than 100,000 professional hours have been applied to the SPICE project. The SPICE team devoted a significant portion of this time to developing the methodology by which the Office can continue this type of auditing as part of its regular audit programs. With its original purposes having been served, the SPICE project as such has now been completed.

Some Underlying Causes for Deficiencies in Resource Management

1.29 The most basic issue emerging from the SPICE project and value-for-money auditing is a deceptively simple but nonetheless vital question: why do serious managerial weaknesses continue to persist even after years of conscientious effort to overcome them? It may be impossible to identify with certainty all the underlying causes of the serious deficiencies in the quality of management of public funds giving rise to the opinion in paragraph 1.3. But, if the lack of adequate attention to economy, efficiency and program effectiveness which has characterized the recent past is to be avoided in future, some observations as to possible causes may be useful.

Impact of the Growth in Government Expenditures on Management

1.30 When the (Glassco) Royal Commission on Government Organization reported in 1962-63, budgetary expenditures of the Federal Government amounted to \$7,304 million. For the fiscal year 1977-78, government expenditures totalled \$42,882 million, an increase of 487% since Glassco. Exhibit 1.1 shows the trend in levels of government expenditures since Glassco.

Exhibit not available

1.31 The Glassco Commission recommended a substantial decentralization to departments of responsibility for financial management and control. But it also called for a concurrent strengthening of the Treasury Board and its Secretariat to develop and implement policy and procedural guidelines for financial administration and effective procedures for monitoring and ensuring compliance. The decentralization was implemented fully, culminating in 1969 with the abolition of the Office of Comptroller of the Treasury. The recommended counterbalancing controls in the Treasury Board were not implemented effectively, as my annual Reports in 1975 and 1976 clearly stated.

1.32 Even if they had been implemented, it is somewhat doubtful that the strengthened organization and procedures would have been able to cope adequately with the rapid and continuous rise in the level of government expenditures. In any event, control of the public purse had eroded dangerously by the time I so reported to the House of Commons in 1976.

1.33 The Glassco Commission observed that "funds are appropriated by Parliament to the Executive, but departments generally assume that it is 'their' money, once a sum is voted". Over the years since Glassco, a generation of managers came into positions of responsibility during a period of general economic buoyancy where emphasis was largely on conceiving and developing new programs, on broadening existing ones, particularly in the field of social welfare, and on the delivery of programs. It was probably inevitable that a set of values would develop among managers in which these aspects of their responsibilities took on paramount importance while close attention to the economical and efficient management of human and financial resources was significantly less important to them.

1.34 It is probably not surprising that managers at all levels, lacking an effective financial management and control system, both centrally and departmentally, and most likely overwhelmed by the steep rate of growth in the size of government, had little time to be concerned about value-for-money considerations in making expenditures of public funds. In short, a sense of personal accountability for the economical, efficient and effective management of public funds and resources does not seem to have been a key characteristic of managerial responsibility in the public service of Canada. On the contrary, during the period of rapid expansion in the Federal Government, it appears that the public purse was gradually deemed virtually bottomless and that access to it was not unduly restricted for the ingenious.

1.35 I must state emphatically that our findings should not be taken as an indictment of public servants for ineffective management of public funds and resources. In this aspect of their responsibilities, their mandate was unclear and their training inadequate. If our findings are an indictment of anything, it is of the system which apparently puts more emphasis on developing policy initiatives and new programs than on the principles and well-established practices of economical, efficient and effective resource management.

Lack of Incentives for Effective Management of Human Resources

1.36 To date we have undertaken only preliminary studies of the efficiency and economy of the salary and payroll costs component of departmental and agency programs. Our work in the area of measuring efficiency, described in Chapter 4, was a first step. In the coming year, more resources will be applied to the audit of other aspects of government-wide payroll expenditures. However, already it is apparent that certain elements of the personnel system are not conducive either to economy or to efficiency.

1.37 As the Public Service Commissioners recently remarked in a public statement, part of the management problems of today "is due to the lesser incentives towards good management that generally characterizes public services, relative to the private sector". The present system of personnel management seems to offer few rewards and incentives -- tangible or intangible -- for economies in using human resources. In fact, the system appears to provide actual disincentives for managers to promote the economical and efficient use of resources -- human and financial.

1.38 These matters are already under study by the Royal Commission on Financial Management and Accountability, by the Special Committee on the Review of Personnel Management and the Merit Principle in the Public Service, by the Treasury Board and by the Public Service Commission. No doubt these bodies will have remedies to propose. In the meantime, we shall carry on with our audit examinations of payroll and salary costs from the

standpoint of whether such expenditures are being made with due regard for economy and efficiency.

Financial Management and Control Systems

1.39 The gross inadequacy of financial management and control systems in departments, agencies and Crown corporations and at the government-wide level, which was one of the principal subjects of my 1975 and 1976 Reports and on which significant action has been taken by Government as reported in my 1977 Report, has undoubtedly contributed seriously to deficiencies in resource management. With many government entities lacking both a meaningful financial information system and a properly qualified Comptroller on the top management team, it is not surprising that economy, efficiency and program effectiveness did not receive the attention required and deserved.

1.40 Fortunately, the Government has begun to redress the critically serious inadequacies in its financial management and control systems by establishing the position of Comptroller General and appointing to it a person with excellent qualifications. But the Comptroller General cannot discharge his important responsibilities with maximum effectiveness unless the Government and Parliament itself -- supports him by giving the clearest possible direction to the public service that all expenditures of public funds not only must be subject to fully adequate financial control procedures but also must be made with the most careful, demonstrable attention to economy, efficiency and effectiveness.

Inadequate Internal Audit

1.41 In my 1975 annual Report, I sharply criticized the quality of internal financial audit throughout the Government. A government-wide follow-up study in 1978 made it quite apparent that, until very recently, virtually nothing had been done to improve this serious situation. Furthermore, in most cases any operational or management auditing was sporadic and divorced from internal financial audit. Under such circumstances department heads and their top management teams lacked an important -- indeed an essential -- management tool to keep them continuously informed on the effectiveness of programs and on the economy and efficiency with which they were being delivered. The lack of an effective internal audit function in many departments reflects both a lack of priority attention to this matter by the departments concerned and presumably a lack of understanding on the part of management as to what is needed.

Accountability

1.42 The common theme running through each of these observations is the obvious absence of an overriding philosophy and of a clear-cut system of accountability for the effective management of financial resources entrusted by Parliament to the Government and by the Government to managers. The financial information system on which Parliament itself must rely, consisting mainly of the annual Estimates and Public Accounts, is inadequate for promoting economy, efficiency and program effectiveness and for holding both the Government and program managers accountable for results.

Three Pillars for Improved Resource Management

1.43 The underlying causes of deficiencies in resource management described above largely suggest the nature of the reforms required. In a recent address, the Prime Minister himself suggested the attitudinal change required when he said that the new axiom of the Government would be "more for less". Many within the public service have interpreted the theme of the Glassco Commission's recommendations as "Let the managers manage". Some have suggested that the theme for today, in the present climate of economic restraint, should be "Make the managers manage". I prefer the theme "Help the managers manage" and suggest that, to expedite improvements in the management of government resources and to obtain "more for less", attention and action be focused on what might be described as three of the more important pillars supporting economical, efficient and effective management:

- an appropriate financial management organization structure and team led by thoroughly competent Comptrollers;
- properly-designed, reliable, timely and responsive financial information systems serving as the core of the total management information systems incorporating both financial and non-financial data; and
- a comprehensive, integrated, and co-ordinated internal auditing function, incorporating economy, efficiency and program effectiveness evaluation and led by a thoroughly competent professional in each department responsible directly to the Deputy Head.

Financial Management Organization Structure (Chapter 8)

1.44 By accepting in 1977 my key 1976 recommendation to establish the position of Comptroller General of Canada and by appointing Harry G. Rogers as the first Comptroller General in 1978, the Government took a positive and constructive step toward creating an effective financial management organization structure at the central agency level. A further step that should be taken is to recognize similarly at departmental and agency levels and in Crown corporations the need for properly qualified Comptrollers with responsibilities commensurate with the new and demanding requirements for the more effective management of human and financial resources in a period of restraint.

1.45 In 1975, I first recommended in my annual Report that the duties, responsibilities and qualifications of the senior financial officer in each department should be broadened and strengthened, and that this officer should become a member of the top management team (however described, usually as the Management Committee). Preferably, such an officer should have the designation of Comptroller in combination as appropriate with another designation such as Assistant Deputy Minister. However, notwithstanding the announcement in December 1976 by the President of the Treasury Board in the House of Commons that the Government supported this recommendation, which was subsequently endorsed by the Public Accounts Committee, a number of departments have still to act. In some cases, appointments to these key positions have been deferred to permit consultation with the Comptroller General, a highly desirable course of action. Now that this senior officer has been appointed, departments which deferred appointments should consult him on further action on this key step.

1.46 To help clarify this important matter, Chapter 8 of this Report sets out in detail the proposed responsibilities, qualifications and reporting relationships of Departmental Comptrollers.

Improved Financial Information Systems (Chapter 6)

1.47 In each of my last three annual Reports, I strongly recommended that the Treasury Board Secretariat study the way the Government submits financial information to Parliament in the form of the annual Estimates. No action on this recommendation was taken until quite recently when a task force was established for this purpose in the Secretariat's Program Branch. The basic objective is to make the information more meaningful to parliamentarians in general and in particular to members of the various standing committees responsible for reviewing the Estimates. What is required is a clearer description of program goals, the means by which they are to be achieved, how the responsibility for achieving them is to be assigned and how program results are to be measured. With the growth in the size of Government during the last 10 years or longer, an attempt has been made to present the Estimates in a uniform format to keep them within one volume. It seems clear that this approach is not working properly and new approaches should be considered.

1.48 Because of the importance of this matter, which bears directly on both the Estimates and the Public Accounts and is a key factor in the ultimate financial accountability of the Government to Parliament for the expenditures of public funds, Chapter 6 and Appendix D of this Report illustrate alternative ways in which information already existing within departments could be presented to Parliament in the Estimates.

1.49 The main issue arising from our study of the Estimates is the need for improved accountability. This demands more effective monitoring of government departments and agencies by Parliament and involves:

- greater disclosure to Parliament by departments of what they seek to achieve in the current year, how they plan to do it, who will be responsible for doing it and how they plan to measure success;
- greater emphasis on the reliability of information in the Estimates and comparable information in the Public Accounts;
- identification by the Treasury Board Secretariat and the Office of Comptroller General, on behalf of the Government, of the information to be provided in both the Estimates and Public Accounts and action to ensure its integrity and comparability; and
- greater clarity concerning the nature of expenditures that appropriations are intended to cover, so my Office can discharge the responsibility assigned to the Auditor General of calling attention to every case where an appropriation was exceeded or was applied to a purpose or in a manner not authorized by Parliament.

1.50 From management's viewpoint, the Estimates should be the tip of the iceberg, the small visible part of the whole that rests on the detailed plans of managers throughout the Government. Ideally, they should constitute a relatively concise summary of plans managers make to attain the Government's objectives within the resources made available.

1.51 In summary, improving the Estimates would be an important step toward improved financial management in government. Better and more detailed Estimates will lead to

improved financial and operational planning at all levels of management. Improved planning, in turn, will lead to better expenditure control, financial reporting and exercise of all other controls at every level.

1.52 Any improvements in the Estimates will automatically improve the Public Accounts, especially Volume II since it reports the degree of compliance with the spending plans contained in the Estimates. Action to improve the Estimates might well begin by improving the Public Accounts since this would ensure that reliable information can be provided before it is introduced in the Estimates.

1.53 In the coming year my Office will focus attention on Volume II of the Public Accounts to determine whether information Parliament receives on actual expenditures can be improved beyond that available in the Estimates on prospective expenditures. We shall review in detail the financial and other information available to departmental management to determine what portion might be useful to Parliament. The Public Accounts now mirror the Estimates, providing expenditure data in comparable form but containing little additional information. The information on prospective expenditures that can be provided in the Estimates is obviously limited. However, Parliament can be much better informed retrospectively on actual expenditures, as well as on the results they achieve.

1.54 Particular attention will be paid to the non-financial data necessary to assess whether expenditures are made with due regard to value obtained. Such information, when now provided to Parliament, is rarely tied to financial data obtained from the books of account. The natural tendency of departments to submit information that will portray them in the most favourable light needs to be restrained by tying financial figures to the official accounts and by ensuring the integrity of non-financial data.

Comprehensive Internal Auditing (Chapter 12)

1.55 In my 1975 annual Report, I criticized the quality of internal financial audit, pointed out that my Office was unable to place an appropriate degree of reliance on most such programs and recommended that the Treasury Board take action to introduce audit standards and appropriate methodology throughout the Government. The Treasury Board began a study and, during 1978, the Office of the Comptroller General issued a booklet entitled Standards for Internal Financial Audit in the Government of Canada which substantially expands on the direction previously given in the Board's Guide on Financial Administration.

1.56 In my 1977 Report, I stated that my Office intended to re-examine the current status of auditing, both financial and operational, within the Federal Government to ensure, as far as possible, that there was due regard for economy and efficiency in the conduct of this function both in the Government and in my Office.

1.57 Our examinations revealed that internal financial audit within departments generally still falls short of an acceptable standard on which this Office can place appropriate reliance in conducting its examinations. But, even more importantly, our examinations revealed clearly that there was at this time an overriding need for integrating and co-ordinating much more closely all audit and evaluation activities throughout the Government. It was evident that, if positive action were taken both in our Office and by the Government to integrate audit and evaluation activities to the maximum extent practical and feasible, both Parliament and the

Government would be served much more effectively and much more economically and efficiently.

1.58 In January 1978, these preliminary opinions were conveyed to the Secretary of the Treasury Board with the suggestion that similar action to that taken by my Office in introducing comprehensive auditing on a cyclical basis (described later in this Chapter) be initiated as soon as possible under the sponsorship of the Treasury Board itself. In view of the imminent appointment at that time of the Comptroller General, it was agreed that action on this recommendation should be deferred until he took up his duties at the beginning of April. Promptly after that, a further discussion took place with the Secretary of the Treasury Board and the Comptroller General to communicate our findings, observations and recommendations for a much closer integration of audit and evaluation activities and for much more effective co-ordination with our own work. The Comptroller General responded affirmatively to these proposals and constructive action already is under way.

1.59 In addition to the obvious economies and efficiency in auditing activities expected to result from introducing and operating the above plans, a comprehensive internal audit along the lines discussed in Chapter 12 of this Report is designed to provide the deputy minister and departmental managers at other levels throughout each department with the means of identifying opportunities for more effective resource management. It will also provide these managers with the information they require, but often do not now have, on whether expenditures of public money under their jurisdiction are being made with due regard for economy and efficiency and whether procedures are in force to assess the effectiveness of programs wherever appropriate.

1.60 It is important to recognize that what we strongly recommend here is a totally new concept of the internal audit and evaluation function. Until now it has been largely a fragmented function operating at relatively low levels without much recognition by senior management. But when properly organized, coordinated and led, it can be one of the sharpest and most effective tools available to management to ensure that it manages the resources for which it is accountable economically, efficiently and effectively. To discharge its important mandate with full effectiveness, it is vital that this function be headed by a professionally qualified executive with direct line responsibility to the Deputy Head who usually should be the Chairman of the Audit Committee.

Conclusion

1.61 Although indispensable to good management of human and financial resources, effective financial management and control and evaluation systems are not in themselves a universal panacea or a substitute for applying soundly-based management principles and practices, good managerial judgment and plain common sense. Furthermore, at a time when cut-backs and retrenchments are required, there is always the risk that the economical, efficient and effective will receive the same treatment as the wasteful, inefficient and ineffective. Some of this is probably inevitable. However, the sooner each department can be satisfied that it has a soundly-based financial management and control system

- headed by a competent Comptroller as a key member of the management team;
- reinforced by a reliable and meaningful management information system; and

- audited by a fully-integrated comprehensive audit and evaluation group led by a thoroughly competent professional responsible to the deputy head;

the quicker the Government of the day -- and Parliament -- can receive the necessary assurances that it is indeed obtaining "more for less".

Comprehensive Auditing for Parliament - A New Cyclical Approach (Chapter 11)

1.62 In my 1977 Report to the House of Commons I stated that we had begun to examine our auditing procedures as well as those of internal audit groups located either in a central agency or in the various departments. This examination had several purposes:

- to determine whether our own auditing activities were being conducted with due regard for economy and efficiency;
- to ascertain the extent to which the methodology developed during the three major special studies since 1973 -- the Financial Management and Control Study, the Computer and Information Systems Evaluation and the Study of Procedures in Cost Effectiveness -- could appropriately be incorporated in the audit programs of the Audit Office;
- to assess the nature and quality of internal auditing and evaluation within the Government and determine the extent to which reliance can be placed on such work by our Office, with a view to avoiding duplication and eliminating unnecessary work; and
- to identify desirable changes in the way we report the results of our examinations to Parliament.

1.63 On the basis of this study, it was decided by our Management Committee to implement what we have termed a comprehensive auditing plan embodying cyclical examinations and reports and comprising the following five separate but closely inter-related components for which the acronym FRAME is used:

- Financial Controls
- Reporting to Parliament
- Attest and Authority
- Management Controls
- EDP Controls

1.64 Two of these components, Attest and Authority and Reporting to Parliament, have been fundamental to the Audit Office since its inception 100 years ago. Two others, Financial Controls and EDP Controls, are new in that they reflect contemporary audit practices which are being incorporated in the regular audit programs of the Office. The fifth component,

Management Controls, is very new in Canada. It represents the methodology the Audit Office is developing to conduct value-for-money auditing.

1.65 The Financial Controls component is essentially the follow-through of the Financial Management and Control Study (1974-76) which introduced system-based auditing to the Office. The EDP Controls component, encompassing rather specialized and sophisticated methodology for computer audits, was developed for the Office during the Computer and Information Systems Evaluation Study (1976-77). The Management Controls component embodies the types of examinations in the areas of economy, efficiency and program effectiveness which we developed through the Study of Procedures in Cost Effectiveness (1976-78) and which we shall continue to develop as further experience is gained.

1.66 By tradition, and under the requirements of the Canada Business Corporations Act, corporations are geared to an annual business cycle. Corporate auditors are required to express an opinion on the fairness of the financial statements presented annually to shareholders. Government accounting also is geared to an annual cycle based on the annual presentation to Parliament of the Estimates, the voting of supply, and the compilation and presentation of annual Public Accounts. The Auditor General Act requires Parliament's auditor, like the corporate auditor in the private sector, to express an opinion on the annual financial statements presented to Parliament. It also requires him to bring to the attention of Parliament certain matters that he has observed during the course of his annual examinations. Compliance with these requirements has been and remains the legal foundation of the Auditor General's mandate from Parliament.

1.67 But the adequacy of the financial management and control systems, including those parts involving computerized data processing, is not related directly to an annual cycle. Neither is the new mandate to examine expenditures from the standpoint of economy and efficiency and to ascertain the adequacy of procedures for the evaluation of program effectiveness. To attempt to carry out these essential parts of the audit examination on an annual basis for all the entities we audit would be impractical and prohibitively expensive. Furthermore, adherence to an annual cycle for these newer components of the audit examination would likely result in an indigestibly large Report to the House of Commons which the Standing Committee on Public Accounts would find difficult, if not impossible, to deal with effectively in the year following its submission.

1.68 Accordingly, the most practical and economical approach appears to be a cyclical plan of comprehensive auditing. Under the plan, Parliament will continue to be provided annually with the information on the official financial statements of the Government and of those entities requiring an annual attest and compliance audit, fully in accordance with existing legislation. The findings and observations arising from other components of the audit examinations, essentially those relating to financial controls and value for money, will be presented to Parliament annually, based on a four-year cycle. This four-year period coincides with the average life of a Parliament. From the standpoint of Parliament, and more particularly the Public Accounts Committee, we intend to include in our annual Reports to the House of Commons at least once in each four-year period summaries of the results of our comprehensive audit examinations in each major entity that we audit. This will provide the opportunity to make Parliament aware of our findings and observations, both positive and negative, on the quality and appropriateness of the financial control, reporting and administrative systems in operation in each entity. Where we note deficiencies and shortcomings, we shall place appropriate recommendations on record together with responses obtained from management.

1.69 The implications of this plan, described further in Chapter 11, are important and far-reaching. We developed and are implementing it in an effort to serve Parliament more effectively and with due regard for economy and efficiency. This centennial Report introduces examples of comprehensive auditing conducted on a cyclical basis. As will be observed in the Tables of Contents, Part 1 includes matters of a government-wide nature mainly affecting central agencies including the Office of the Comptroller General, the Treasury Board Secretariat and government-wide service agencies, such as the Department of Public Works. Part 2 contains matters relating primarily to departments, both those identified with our first Comprehensive-style audits and those other matters observed during our annual examinations that we consider must be brought to the attention of Parliament at the time they are identified.

1.70 Our annual Reports, containing summaries of the comprehensive audits of selected departments, agencies and Crown corporations presented usually at four-year intervals for each entity, or more frequently if justified by unusual circumstances, will permit Parliament to:

- assess the quality of financial administrative management;
- receive the necessary assurances that public funds and resources are under adequate control and are being managed with due regard for economy, efficiency and effectiveness; and
- initiate actions to remedy unsatisfactory situations or substandard procedures.

Advanced Studies in Comprehensive Auditing Methodology

1.71 In this centennial year of the Audit Office, we organized and launched an intensive internal program to commit to writing the methodology that we have been developing during the last five years through our major government-wide special studies (FMCS, CAISE and SPICE). We are preparing a revised audit manual, an instruction course and a Guide to Comprehensive Auditing Methodology as Developed and Applied in the Office of the Auditor General of Canada. These aids to our professional activities are essential to ensure the application of consistent audit standards, procedures and practices throughout all of our work in departments, agencies and Crown corporations.

1.72 The five basic components of the program for which the acronym FRAME is used are as described earlier in this Chapter: F - Financial Controls; R - Reporting to Parliament; A - Attest and Authority; M - Management Controls; and E - EDP Controls. We plan to develop additional suitable material for such activities as planning a comprehensive audit on a cyclical basis and co-ordinating audit programs with departmental internal audit and evaluation activities.

1.73 I have informed my counterparts in the provinces of this program and have undertaken to keep them fully acquainted with its progress, bearing in mind that several provinces have already enacted, or are considering enacting, legislation generally similar to the new Auditor General Act.

1.74 I have also advised the Comptroller General of this program and intend to keep him fully briefed on its progress, recognizing that, if central and departmental levels accept our key recommendation for comprehensive internal auditing and evaluation, there may well be

excellent opportunities for cooperation in developing and implementing consistent professional audit standards and practices with obvious possibilities for economies by avoiding duplication of instruction effort and facilities.

1.75 As we enter the second century of service to Parliament and to Canadians, it is a pleasure to report, on behalf of all my colleagues in the Audit Office, that we do so with vigour and enthusiasm and with a high sense of dedication and purpose to carry out effectively the mandate entrusted to us by Parliament.

1978 Report of the Auditor General of Canada - Chapter 2

```
<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Value-for-Money Auditing</H1>
</CENTER>
<IMG SRC="../../graphics/linegra3.gif" WIDTH=100% ALT="line">
<HR>
```

Background

2.1 In many countries besides Canada, value-for-money auditing has been one response to the increasing concern of legislators and senior government officials with the results of public expenditures -- in other words with issues of economy, efficiency and effectiveness. This, an extended approach to auditing, goes beyond the important but limited concerns of proper financial accounting. As a simple example, suitable financial controls can ensure that employees are paid for the time they work at their appropriate rates of pay. Such controls cannot, however, ensure that their time is being used efficiently or that the work they are doing is necessary.

2.2 Auditors General in Canada have long been indirectly concerned with value for money. Although Watson Sellar did not use the term, he defined both *ex gratia* and nugritory payments in the 1958 edition of the Audit Office Guide. Audit Officers were instructed to call attention to those types of payments and constructive losses which, although differing technically, have a common characteristic - either no service was rendered or the expenditure did not have the utility intended. When the Auditor General felt they merited public attention, his Report contained observations on such expenditures.

2.3 A more comprehensive, formal recognition of the need for value-for-money auditing in Canada resulted from the work of the Independent Review Committee on the Office of the Auditor General of Canada, appointed in October 1973 and chaired by the late J.R.M. Wilson, F.C.A. The Wilson Committee inquired into the responsibilities of the Office of the Auditor General, its relationships with government departments and agencies and its reporting procedures. It considered the "statutory and other requirements to ensure that he can meet such responsibilities with the necessary degree of independence." The Committee drew on its own experience, on its investigations in Canada and on experience in other countries. It examined at length the relationships between the Office and the Public Accounts Committee, the Minister of Finance, the Treasury Board, the Public Service Commission, internal governmental audit groups and other professional and governmental auditing organizations.

2.4 The Wilson Committee examined in detail the content, method of preparation, timing and form of reports by the Auditor General -- focusing on the relationship between the fundamental concepts of accountability and audit. In this context, the Committee noted in its report dated March 27, 1975, that government auditors should advise legislatures whether funds they grant to the administrative arms of government have been properly used. It construed this audit responsibility broadly, proposing a place in it for value-for-money auditing as part of a far-ranging set of recommendations on the work of the Office.

2.5 As to the statutory authority of the Auditor General and the evolution of his reporting responsibilities to Parliament, the Committee concluded that he should:

"... take due account of economy and efficiency in conducting his examination of expenditures. Since some confusion has arisen on this point in the past, it would be

desirable that ... new legislation provide a specific authority for him to report cases where, in his opinion, value for money has not been obtained through the Government's expenditure of public funds."

2.6 In the same section of its report, the Wilson Committee also addressed the role of the Auditor General in reporting to Parliament on matters concerning the effectiveness of programs. It noted that Parliament's expectations in legislation are not always readily discernible, nor are the results achieved always measurable with reliable techniques. The Audit Office, the Committee concluded, should take a great interest in the progress of effectiveness measurement:

"... the Audit Office should develop sufficient expertise to identify those areas of government to which effectiveness studies could be applied and to assess the validity of any conclusions that result."

Furthermore,

"The fact that the systematic evaluation of program results presents problems of identification and evaluation should not be taken as an excuse to question the Auditor General's right of reporting on obvious cases of ineffectiveness uncovered during the course of his examination of the accounts."

"Because the evaluation of the effectiveness of programs is an integral part of the value-for-money concept, it is important that the new legislation be broad enough to ensure that the Auditor General has the right to report on such studies and even to make his own evaluation of program results if there is no other satisfactory way of obtaining this. For the present, the initiative should rest with the Treasury Board and operating departments, but efforts should be accelerated. Some countries are making considerable progress in this direction, and there is no reason why Canada should shy away from it."

2.7 These and other positions taken by the Committee were the subject of further discussion and contributed to the drafting of the Auditor General Act, 1976-77, c. 34, which was proclaimed on August 1, 1977. Section 7(2) of the Act sets out the legislative foundation of value-for-money auditing:

"Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that .

(d) money has been expended without due regard to economy or efficiency;
or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented."

It is important to note that although the Act requires the Auditor General to assess whether expenditures have been made with due regard to economy and efficiency, it does not call upon him to "make his own evaluation of program results" as suggested by the Wilson Committee. Instead, it requires the Auditor General to report on the absence of satisfactory procedures for measuring and reporting the effectiveness of programs.

Audit Criteria

2.8 As with any audit, value-for-money examinations by the Office of the Auditor General lead to opinions based on a comparison of the facts observed in any given situation with a set of generally accepted management practices or criteria. In the case of financial audits, the standards are defined by precedent and documented in publications such as the Financial Administration Act, the Canadian Institute of Chartered Accountants' Handbook and the Treasury Board Guide on Financial Administration. These provide adequate points of reference. In contrast, value-for-money auditing is a relatively new area of professional practice. There are few documented guides and precedents are scarce. Within the Government of Canada, there are two general situations:

- Areas covered by directives and guidelines issued by the Treasury Board. These include performance measurement and program evaluation, which relate to the two government-wide areas covered in Chapters 4 and 5 of this Report. The Board's Benefit Cost Analysis Guide and its recently issued Policy and Guidelines on the Management of Major Crown Projects have a bearing on a third area, the planning of capital asset acquisitions which is discussed in Chapter 3. We used these directives and guidelines as one of our sources for identifying audit criteria against which to assess the management process of a given operation.
- Areas for which no guidelines exist. The Office developed general criteria against which to assess the adequacy of the management process in a given operation.

2.9 Managerial requirements in one operation may differ from those in another. In a given situation, there is more than one way to manage successfully and more than one single type of valid management information. These factors, combined with a recognition that expressing audit opinions on value-for-money is a relatively new and imprecise area of professional practice, led us to state our audit criteria in very general terms. Each value-for-money audit interprets these criteria in relation to the operation under scrutiny. Therefore, although value-for-money audit examinations have a generally consistent treatment, the range of interpretation is somewhat broader than in financial audits.

2.10 In each topic reported on a government-wide basis, we have stated our audit criteria. Our government-wide conclusions, findings and recommendations should be viewed in light of these criteria, by which individual operations also have been judged.

Definitions of Economy, Efficiency and Effectiveness

2.11 In planning and conducting our audits during the last year, we began the process of defining the three key terms used in the Auditor General Act to describe our value-for-money audit responsibilities -- economy, efficiency and effectiveness. We shall continue to develop these definitions as our audit experience accumulates.

2.12 Economy refers to the terms and conditions under which the Government acquires human and material resources. An economical operation acquires these resources in appropriate quality and quantity at the lowest cost. If control mechanisms are not in place, programs may be overstaffed or understaffed, or inappropriately equipped in other ways to deliver the expected results.

2.13 Efficiency refers to the relationship between goods or services produced and resources used to produce them. An efficient operation produces the maximum output for any given set of resource inputs; or, it has minimum inputs for any given quantity and quality of service provided.

Efficiency is obviously more measurable and more controllable in some situations than in others. The underlying management objective is increased productivity.

2.14 Effectiveness concerns the extent to which a program achieves its goals or other intended effects. For example: to increase income in a particular area, a program might be devised to create jobs. The jobs created would be program output. This contributes to the desired program effect of increased income which can be measured to assess program effectiveness. Of course, not all programs are equally evaluable. Also, management procedures for measuring and reporting effectiveness will differ between programs.

2.15 Our assessment of management in the effectiveness area starts with obtaining an understanding of and recording program objectives, goals and effects. We then examine the adequacy of management systems that evaluate and report the extent to which they are being achieved. It is not our responsibility to question the appropriateness of program goals or the values underlying them; this is the responsibility of Parliament.

A Special Project: Study of Procedures in Cost Effectiveness (SPICE)

2.16 In 1976, the thrust of the Report of the Wilson Committee and the drafts of Bill C-20, the Auditor General Act, clearly indicated a need to focus significant Audit Office resources on value-for-money auditing. A special project within the Office was announced in paragraph 19.14 of our 1977 Report:

"Recognizing the imminence of the introduction of the Auditor General Act and, consequently, the pressing need to prepare my Office for its new responsibility, in September 1976 I initiated the Study of Procedures in Cost Effectiveness with the following objectives:

- to compile information on the 'state of the art' of management control systems in the public sector, in terms of economy, efficiency and effectiveness;
- to assess and report on existing procedures for planning, measuring and controlling activities in Canada's public service (in the interests of economy, efficiency and effectiveness); and
- to recommend to the Office of the Auditor General how this new mandate should be exercised in the future."

2.17 Where economy and efficiency are at issue, we can choose to analyze and report the facts of the situation. For example, we can assess the efficiency of an operation by comparing actual outputs to engineered standards or we can take a "systems approach" focusing attention on the availability and use of information. Do managers receive information adequate for determining the efficiency of an operation? When the information indicates low efficiency, have they taken appropriate action? Our audits have concentrated for the most part on systems. The adequacy of management information has been our primary concern, especially in the area of effectiveness evaluation. In some studies we have probed more deeply to make our own assessment of the economy or the efficiency of an operation. We have reported these assessments where the results are significant.

Project Organization and Methodology

2.18 In line with the practice of previous special studies conducted by the Audit Office, SPICE has been staffed by a mixture of members of our full-time staff and professional consultants recruited from management consulting firms, accounting firms and universities under the Executive Interchange Program of the Public Service Commission or on personal service contracts. Thirty-two such organizations have provided staff for the project and 90 professionals have participated. Over the life of the project, the level of effort has averaged the equivalent of 40 people, 13 public servants and 27 contract staff, working fulltime.

2.19 The Auditor General established a Senior Advisory Committee for SPICE through which the senior partners of national management consulting firms have provided advice and guidance. They reviewed our government-wide conclusions, findings and recommendations as these were developed throughout the course of the study. The Committee members are:

Kenneth G. Belbeck, C.M.C. (Chairman)	Stevenson & Kellogg
Gordon H. Cowperthwaite, F.C.A., C.M.C.	Peat, Marwick and Partners
Richard Mineau, LL.L., C.M.C.	Price Waterhouse Associates
Jack M. Smith, C.M.C.	Woods, Gordon & Co.

Mr. George N.M. Currie, B.Eng., M.Sc., formerly Chairman of Currie, Coopers & Lybrand Ltd., was a member of the Committee until he resigned from his firm early in 1978 to accept an executive position in industry.

2.20 SPICE began in September 1976 with pilot projects in three departments. The work summarized in this Report began in January 1977, when audits were initiated to examine certain aspects of management in a number of departments. Our audit programs focused on a wide variety of government programs and activities, partly as a means of exploring the implications of the Auditor General Act. They sought to: (1) develop methodology and contribute findings on one of the aspects of management, such as planning, operational productivity, program evaluation, etc.; and (2) investigate one or more of these judged to be significant within the department being audited.

2.21 Preliminary surveys in a number of departments identified areas for possible audit examination under the value-for-money mandate. Typically, of several areas identified, one was selected for immediate investigation. The remaining potential studies may be pursued in the future as Principals of the Office develop their audit programs for individual departments.

2.22 By August 31, 1978, we had launched 52 value-for-money audit projects. Thirty-five projects had been completed and interim reports released to departments for comment and response. These 35 reports provide the basis for the discussion of issues of government-wide significance in the following three chapters. Chapters 14 to 19 of this Report, which contain summaries of our comprehensive audits in six departments, include the results of the 16 SPICE projects conducted in those departments. Some of our SPICE examinations did not identify matters of sufficient importance for reporting to Parliament.

2.23 The findings of all SPICE examinations have been discussed at length with departmental program managers and deputy heads. Because quality of management, the subject of SPICE audits, is an area open to interpretation and therefore to differences of opinion, we have carefully briefed departments on our views, verifying facts and discussing interpretations. We have been impressed by

the prompt and constructive response. Departmental managers have initiated many improvements to correct identified weaknesses and have increased efforts to implement solutions to problems that had been identified prior to our audit.

2.24 Development of a suitable audit methodology has also been an important part of SPICE. This emphasis on investigative guidelines and related development programs for audit staff will continue indefinitely. One of the significant features of SPICE's methodological contribution has been its emphasis on value for money in the audit process itself. This has led to the reinterpretation of audit work program development, which starts with a preliminary review of resource management problems or issues and helps the Office establish a cycle of audit priorities. The perspective on situations of suspected weak management practices can sometimes be long. In this Report, for example, some of the capital acquisition inquiries relate to projects that were initiated almost 10 years ago. Such auditing demands techniques somewhat different in emphasis from those more traditional to the Office.

2.25 At the heart of the investigative methodology is an evolving set of "audit criteria" based on standards of management Parliament can reasonably expect from the Government. The development and exploration of these criteria have been an underlying function of SPICE. The purpose is twofold: first, to improve the quality and cost effectiveness of value-for-money audits; and second, to encourage the further promulgation, adoption and active use of recognized management practices in government.

2.26 SPICE methodology is evident in the following three Chapters of this Report that deal with planning capital acquisition projects, measuring and increasing efficiency and evaluating effectiveness. It is also being developed in several other areas of future audit interest.

2.27 For planning, as it relates to capital assets projects, we have developed a fairly complete investigative methodology. It reflects expert opinion, experience in other jurisdictions and our observations in the Public Service of Canada. Much more remains to be done, however, on the treatment of planning issues in other kinds of government programs.

2.28 SPICE benefited from two well recognized streams of experience in the area of measuring and increasing efficiency: first, the long history of systematic efforts to improve labour productivity that now stretch back more than two generations; and second, the efforts of the Treasury Board Secretariat and departments in the last 10 years to measure and improve public service efficiency. Some kinds of public service work are more amenable than others to "productivity improvement." Even so, there is ample opportunity to increase value for money through greater efficiency. By and large, this calls for straightforward concepts and methods.

2.29 Evaluation of effectiveness summons up a different order of problems. Opinions differ on the feasibility, merits and longer-term utility of formal attempts to measure and otherwise evaluate the outcomes of public programs. To what extent can the goals for new programs be defined so as to lend themselves to measures of their achievement? How much money should be spent on evaluation? Which particular evaluation research techniques should be applied? To date, we have concentrated on two areas: first, evaluability assessment methods to identify measurable outcomes of programs; and second, the state of the art in evaluation research, so that program evaluation studies can be audited for soundness of procedure and reliability of result. SPICE methodology reflects our interest in more and better program evaluations, as called for by the Treasury Board.

2.30 To consolidate and pass on SPICE experience, the Audit Office is preparing new audit manuals, reporting guidelines and professional papers. Ahead lie the challenges of staff training and

development of audit teams with broader professional competence in what we term comprehensive auditing -- described more fully in Chapter 11 of this Report. In these ways, the Office plans to maintain its effectiveness in serving Parliament.

1978 Report of the Auditor General of Canada - Chapter 3

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Planning Capital Acquisition Projects</H1>
</CENTER>

<HR>

Background

3.1 The prevailing period of budgetary restraint, extending into the foreseeable future, gives added significance to planning as the Government seeks to channel new funds in the most productive directions and release funds for higher priority uses. Planning covers a wide range of activities -- from the very broad such as the process of establishing government priorities, to the very detailed such as setting out a day's work in a clerical function. Planning processes have implications for all aspects of the value-for-money mandate. Acquisition decisions raise basic issues as to "appropriate quality at a minimum cost" -- the economy question. Projects to plan, acquire or build capital assets raise issues of efficiency as part of project management. Effectiveness evaluation can be facilitated or frustrated according to the clarity of objectives and intended effects that are specified at the planning stage.

3.2 Our findings in one aspect of planning, capital acquisition projects, are sufficiently well developed to report at this time. These findings concentrate on the economy aspects of projects and in some instances, consider the efficiency aspects as well. In the future, we expect to examine and report on additional aspects of planning that fall within our audit mandate.

Scope

3.3 The SPICE project has conducted a number of examinations of planning as it relates to capital acquisitions. To examine a reasonable cross-section of capital acquisitions, we selected departments with major capital expenditures. Within these departments we identified projects for examination on the basis of:

- the size of the project, concentrating on larger rather than smaller projects; and
- previous investigations and audits already under way.

3.4 The capital acquisitions we have examined are not necessarily representative of all such projects the Government carried out in recent years. Rather, they are a selection of important projects with estimated final costs amounting to \$699.7 million. The total for capital expenditures in the 1977-78 Main Estimates was \$1,838.6 million. Total approved capital cost of projects under way during 1977-78 is estimated at \$10,000 million, excluding capital contributions for such programs as flood control, sewage disposal plants and Central Mortgage and Housing Corporation housing assistance. These sums do not include the operating and maintenance costs of the facilities. Over the useful life of a capital asset, such costs typically amount to at least as much as the capital cost. Projects examined in detail were recently completed or were in the final stages of completion. During 1977-78, expenditures on these projects amounted to \$161 million. Because of the nature of the projects, initial authorizations may have been given up to 10 years ago.

3.5 Our work consists of post-audits -- examining results after the fact. Accordingly, we review the documentation prepared at the time decisions were made and observe the subsequent events including the results of procedures applied to the projects in question. In some cases, departments have informed us that they have installed procedures intended to eliminate, in future projects, the problems we identified. We support these initiatives, but cannot judge the efficacy of procedures not yet implemented. Our findings are cited here to highlight the importance of proper planning and control procedures. Procedures, however, are only tools which assist management. They contribute to and must be accompanied by the dedicated pursuit of the objective of economy.

Audit Criteria

3.6 In the initial stages of our work, we drafted audit criteria for capital acquisitions. They were tested and in some cases modified during the field examinations. The following are the criteria that emerged.

3.7 Responsibility and accountability should be clearly defined and communicated.

- Responsibility and accountability for analyzing needs, setting objectives, conducting feasibility studies, developing proposals, exercising control over design and construction and reviewing completed projects should be clearly defined and communicated.

3.8 Requests for funds should be supported by accurate and complete documentation.

- Each capital acquisition should begin with an unbiased analysis of the need to be met and its relationships to statutory and departmental objectives, care should be taken to avoid exaggerating benefits and thereby overstating the need for the project.
- For each capital acquisition there should be a clear written statement of objectives, which should be related to the appraisal of needs. Where feasible, the objectives should facilitate quantitative measurement of the extent to which they are attained.
- Alternative courses of action should be evaluated impartially on the basis of differences in revenues, benefits and life-cycle costs (initial capital costs and the present value of operating and maintenance costs over the life of the asset). Options which should be thoroughly analyzed include contracting out of activities to companies which are capable of doing the required work; leasing, as opposed to outright purchase; repairing or modifying existing facilities rather than replacing them; or delaying the project, perhaps indefinitely.
- Capital cost estimates at all stages of the planning process should be realistic and complete, covering all aspects of the project. A revised estimate based on the actual design, schedule and site conditions should be prepared before seeking final approval. The effects of possible future inflation should be considered, separately from other cost-increase factors. Estimates should be expressed in both current and anticipated future dollar values.

3.9 Final approval should be based on full information.

- Approval for expenditures on construction should be withheld in the early stages of project planning when full information is not yet available. When a project is first

conceived, approval should be given only for funds to conduct feasibility studies, develop a design and prepare cost estimates. As indicated above, one reason for withholding final approval is that an accurate estimate of construction costs cannot be made until site conditions have been assessed and a design has been selected. Accurate estimates are basic to analyses such as benefit-cost studies and cash flow forecasts. Final approval of a project should also await:

- an up-to-date analysis of needs and alternatives;
- rental commitments from major users, in the case of a "user-pay" facility; and
- detailed plans for achieving manpower reductions, in the case of a mechanization project.

3.10 Project implementation should be properly controlled.

- Managers should exercise control over projects during design and construction to ensure that facilities of the approved size and quality are completed on schedule and within the authorized budget. Adequate systems should be used to control changes in design and to report progress, highlighting accountability for decisions taken and results achieved.

3.11 Completed projects should be reviewed.

- Each project should be reviewed on completion to:
 - Ascertain whether appropriate procedures were applied, economy and efficiency were observed and objectives were achieved;
 - evaluate the performance of managers; and
 - develop recommendations for planning and controlling similar projects in the future.

Audit Conclusions

3.12 *Based on 13 SPICE audits completed to date, the capital acquisition process does not come up to a reasonable standard of "due regard for economy." The process suffers from a number of shortcomings which in total indicate that resources of an appropriate quality were not acquired at a minimum cost.*

3.13 *Our findings are not uniform across all projects examined. Deficiencies that affected one project may not have appeared in another. Two of the 13 projects demonstrated reasonable regard for economy.*

Audit Findings

3.14 Our examinations show that good practices that have emerged from many years of project management experience often were not followed in the planning and acquisition of capital

assets. Brief case histories of all capital acquisition projects examined are included later in this Chapter.

3.15 Key aspects of project planning and implementation sometimes received insufficient attention because responsibility and accountability for them were not clearly defined.

3.16 Program managers and departments naturally tend to advocate capital projects that will further the aims of the programs for which they are responsible. However this appears to have been carried to extremes. Central controls have not counterbalanced this to the extent they should. We noted a number of projects where the need for new facilities was not clearly demonstrated or the benefits were exaggerated. The objectives of some projects were not clearly stated in a manner which would permit reasonable assessment of their desirability and subsequent review of whether or not their objectives had been achieved. Moreover, alternative courses of action were not always impartially assessed and presented. Feasibility studies and project submissions generally stressed the option preferred by the department concerned to the detriment of other alternatives.

3.17 The most noticeable feature of the capital projects examined was the extent to which their costs exceeded the amounts originally approved. Exhibit 3.1 shows that total costs increased from \$281.6 million to \$699.7 million according to the latest final estimates, an increase of 148%. The smallest increase occurred in the South Western Ontario Dyking program. However, this reflects a reduction in the scale of the work resulting from the Treasury Board's refusal to approve a substantially increased estimate. Another flood protection program, on the Fraser River, showed an increase in federal contributions from \$18.0 million to \$60.0 million although substantially less work than that included in the original estimate was actually completed. The greatest cost increase, from \$17.0 million to \$108.0 million in the case of the "R" Class Icebreakers project, reflects the escalation from a low estimate made in 1972 for one icebreaker to a subsequent estimate for two icebreakers at \$60.0 million and then to the current estimate of the final cost for the two icebreakers now under construction.

Exhibit not available

3.18 Departments generally do not have a current analysis of how much of the escalation in estimated final project costs is attributable to inflation and how much to increases in the real cost. Increases in real cost generally result from:

- under-estimation of the original project; or
- expansion of the size or scope of the project beyond the original plans.

3.19 Estimating the impact of inflation can be complex because of such factors as the timing of payments, cost escalation clauses in contracts, differences in inflation indices for types of projects and regions of the country and differences in the purchased equipment component. To estimate the inflation component for each project, we adopted simplifying assumptions for our analysis. Based on these assumptions, which are undoubtedly conservative, we estimate that inflation for the projects audited was 82% of the original cost estimates and the real cost escalation was 66% of the original cost estimates.

3.20 The original cost estimates for these projects did not provide reliable information for decision making. Significant expansions in size and scope after projects had been approved were not always subject to appropriate scrutiny and challenge.

3.21 Life-cycle costs, consisting of initial capital costs and the present value of operating and maintenance costs over the life of the assets, were not analyzed during the planning of many of the projects which we examined, although there were a number of cases where operating and maintenance costs should have been a significant factor in decision making.

3.22 Existing budgetary procedures do not ensure that projects are thoroughly reviewed after project planning and design have been completed but before construction begins. Our examinations disclosed a number of instances where reviews at this stage might have raised serious questions about the desirability of proceeding with projects as planned in the light of increases in real costs, the absence of rental commitments for user-pay facilities, and the lack of detailed plans for achieving manpower reductions for mechanization projects.

3.23 Performance on project control was uneven. Although some projects had quite sophisticated planning and control procedures, others suffered from diffuse accountability, inadequate monitoring and reporting and lack of action in the face of changing circumstances.

3.24 Completed projects are not always subject to a formal review even when such a review would be relevant to the planning and control of similar projects.

3.25 On June 29, 1978, the Treasury Board issued a document entitled Policy and Guidelines on the Management of Major Crown Projects. The policy, principles and guidelines it contains are generally consistent with the audit criteria and recommendations arising from our examinations of capital acquisition projects. In particular, they urge the clear definition of accountability and responsibility, better implementation control and a review of completed projects. They do not emphasize to the same degree our criteria and our recommendations that requests for funds be supported by accurate and complete documentation, that final approval be based on full information and that there be an independent review of all project proposals within the sponsoring department before they are submitted to the Treasury Board. The policy and guidelines apply to projects estimated at the concept stage to cost over \$100 million and to projects expected to have major socio-economic impact. Had it been issued before the initiation of the projects we audited, the policy would only have applied to those audited projects judged to have major socio-economic impact.

Recommendations

3.26 *Departments and agencies should implement the new Treasury Board Policy and Guidelines on the Management of Major Crown Projects and should adopt the additional procedures necessary to ensure that for all capital projects:*

- *Responsibility and accountability are clearly defined.*
- *Requests for funds are supported by accurate and complete documentation including:*
 - *a proper analysis of needs;*
 - *a clear statement of objectives and intended effects;*
 - *an impartial assessment of alternatives;*
 - *realistic capital cost estimates; and*

- *an analysis of life-cycle costs.*
- *Final approval is based on full information.*
- *Project implementation is properly controlled.*
- *Completed projects are reviewed.*

3.27 *There should be an independent review within the sponsoring department of all major project proposals to ensure that requests for funds are supported by accurate and complete documentation before their submission for approval by the Treasury Board.*

Case Histories of Capital Acquisitions

3.28 The following case histories, summarizing all capital acquisition projects we examined, are presented to illustrate the current state of management in such projects.

3.29 **Environment - Flood Control.** The Department of the Environment provides financial assistance for flood control programs through contributions to the provinces. These programs seek to reduce the risk of flood damage by the construction of dykes and by non-structural alternatives such as flood plain mapping. The Federal Government becomes involved, through federal-provincial agreements, where the Cabinet considers that a significant national interest exists. The three programs we examined were on the Fraser River in British Columbia (estimated Federal contribution \$60.0 million), in South Western Ontario (\$7.6 million) and in the Montreal area (\$4.5 million).

3.30 Following flooding of prime agricultural land in South Western Ontario, the Department of Agriculture obtained Cabinet approval for a joint federal-provincial program to protect this land against floods. Subsequently it requested Treasury Board approval for funding and the request was approved with the provision that responsibility for the program be transferred to the Department of the Environment.

3.31 In our opinion, the Department of the Environment did not give due regard to economy in flood control projects in South Western Ontario and Montreal. Our audit revealed that on transfer of the South Western Ontario program from the Department of Agriculture, the Department of the Environment did not subject the program to the analysis and planning that normally precedes a Treasury Board submission and the signing of a federal-provincial flood control agreement. Consequently, the Minister of the Environment was not informed in detail of all the relevant economic factors of the program before signing the agreement. Although considerations other than economic rate of return, such as concern over imminent flooding, may affect decisions on flood control programs, due regard for economy requires that the decision maker be provided with an objective analysis of both costs and benefits.

3.32 Our audit also revealed that initial cost estimates made prior to signing the agreements for all three programs were substantially exceeded primarily because of unrealistic initial estimates and, to a lesser extent, because of inflation and changes in design standards. The Fraser River agreement signed in 1968 provided for total expenditures of \$40 million with a federal contribution of \$18 million for 44 projects. By 1976, the estimated total cost had increased to \$120 million with a federal contribution of \$60 million for only 22 projects. In Montreal, program costs doubled from \$5 million to \$10 million, with the federal contribution increasing from \$2.3 million to \$4.5 million in one year. In South Western Ontario, cost estimates exceeded original estimates by year after the agreement was signed. This

resulted in a request to the Treasury Board for additional federal funds of \$5.9 million which was refused on the basis that the project had not been justified on economic grounds.

3.33 Following the signing of a flood control agreement, benefit-cost studies are normally conducted for each project covered. Individual projects in the Fraser River program were carefully planned, monitored and implemented. By contrast, in the South Western Ontario and Montreal area programs, the Department did not ensure that sound benefit-cost studies were conducted. No studies were conducted for three of the five projects in the South Western Ontario program. Consulting engineers did undertake benefit-cost studies for the remaining two larger projects, but the estimated benefits were overstated because of doubtful assumptions and errors in methodology. Costs of \$5.4 million and \$8.7 million were estimated to give \$7.3 million and 11.5 million in benefits but the Department has agreed that incorrect methodology was used in calculating them. Recalculation shows the benefits to be at most \$1 million and \$5.5 million respectively. In the Montreal program, the benefits of one project were calculated with an unacceptable method and inadequate data. The Department did not review any of these studies in detail before implementing the projects.

3.34 Under each of the three agreements we reviewed, project management is a provincial responsibility subject to the general direction of a federal-provincial committee. The federal representatives on these committees did not ensure that implementation of the Montreal and South Western Ontario programs was properly controlled. For example, the dyke at Pointe-Calumet in the Montreal Region was redesigned at the request of the municipality, but no recalculation of costs and benefits was requested. In South Western Ontario, individual dyking projects were implemented without the approval of the Minister as required under the agreement.

3.35 Indian Affairs and Northern Development - Schools. The Department of Indian Affairs and Northern Development is responsible for the education of status Indian children, either in federal schools or in non-Indian communities under agreements with the provinces. The 1977-78 Main Estimates provided \$236 million for Indian education, of which \$33.3 million was for capital expenditures.

3.36 The Department itself was particularly concerned about cost overruns for schools built by the Department of Public Works which used local Indian labour to provide employment and training opportunities. We chose five recently completed projects of this type for audit -- at Lake Manitoba and Wasagamack in Manitoba and at Attawapiskat, Cat Lake and Fort Severn in Ontario. The total cost of these five schools was \$12.8 million, compared to the \$5.6 million approved by the Treasury Board before construction began. The Anicinabe school at Fort Alexander, built within the \$ 1.7 million budget by a commercial contractor, was included as an example of a project executed within the planned cost.

3.37 These schools were constructed to replace older buildings and temporary classrooms. Most of the projects included a gymnasium, library and other ancillary facilities which had not previously been available, additional housing for teachers and water and sewage treatment plants to serve the school complex. Four of the six communities are generally accessible only by air and for limited periods of the year by barge or winter roads.

3.38 In our opinion, the Department of Indian Affairs and Northern Development did not give due regard to economy in these six projects.

3.39 The audit revealed that submissions to the Treasury Board did not contain adequate information on the need for the facilities or on project objectives. For example, the Fort Alexander submission did not describe the existing school, gave no justification for replacing it and did not

disclose that the project would serve high school students for whom facilities had already been built in a nearby non-Indian community at a cost to the Department of \$164,000. Submissions for other schools such as Lake Manitoba and Wasagamack did not disclose the sizes of these schools in square feet per pupil, or in relation to the school size standards then in force, so that it was difficult to judge whether they were unduly large.

3.40 The final cost of the six projects was twice the estimates the Treasury Board approved. A major reason was that the estimates were generally made before the schools were designed and without feasibility studies on water supply and sewage disposal. Moreover, the Department did not request revised estimates, based on the actual design and appropriate feasibility studies, before construction began. It also failed to ensure that cost estimates took adequate account of the difficulties of construction in remote northern locations. For the Attawapiskat and Fort Severn schools, substantially increased cost estimates were received before construction began, but Treasury Board approval for the increases was not sought until later.

3.41 Treasury Board approvals were not sought for the final cost overruns on three of the six school projects we examined. Requests for approval of cost overruns for two schools contained incorrect statements.

3.42 When tenders for the Fort Alexander project were \$300,000 below the estimate approved by the Treasury Board, the Department authorized additions which brought the cost back up to the approved amount of \$1.7 million. With these changes, the design exceeded the general guidelines for school size set by the Treasury Board.

3.43 The Department did not exercise sufficient control over the implementation of projects by the Department of Public Works. In particular, it did not insist on adequate standards of progress reporting or on procedures to control design changes.

3.44 National Defence - Base Development Planning. A key output of the planning process of the Department of National Defence is the determination of force deployment and the supporting structure of military bases. This is reflected through planning guidelines for each base which lead to a detailed base development plan. The contents of this plan should have a major impact on the direction of the facilities maintenance program costing in excess of \$200 million each year.

3.45 At the time of our audit, planning guidelines had been prepared for only 13 of the 32 bases. Only four of the 13 bases with guidelines had approved base development plans, although the need for these was identified in 1972 and a revised base planning policy was developed in 1975. The Department has since informed us that planning guidelines have been completed for 15 bases and are being prepared for three others. Also, seven base development plans have been approved, two more are in the approval process and a further six are being prepared.

3.46 The absence of base development plans for the majority of National Defence bases makes it difficult to:

- plan the facilities maintenance program on a medium to long-term basis in light of anticipated use and life expectancy;
- determine correct maintenance priorities and avoid undesirable day-to-day reaction to operating needs;

- evaluate the economic benefits of replacing a facility rather than maintaining it; and
- achieve continuity of policy and direction, given the frequent change in the senior personnel at each base required by career development plans.

3.47 To ensure the most economic and efficient use of both new construction and base maintenance resources, the Department should give greater emphasis to providing interim guidelines and approved development plans to its bases.

3.48 Post Office Mechanized Letter Sorting System. The Mechanized Letter Sorting System (MLSS) began in 1970 as part of a major modernization program within the Post Office. The system's equipment cost about \$153 million; it will be installed in 31 post offices in 26 cities when the program is completed in 1982. The Post Office's machines sort letters automatically, if they have a postal code.

3.49 In our opinion, the Post Office did not give due regard to economy in this undertaking. The Department's cost effectiveness studies forecast that over a period of 15 years sorting letters with the MLSS would cost \$161 million less than sorting manually for an increasing volume of mail. These studies did not provide detailed information about achieving benefits in the operating environment on a plant by plant basis. The broad goals described in these studies were not translated into operating objectives that could be communicated to postal plants.

3.50 Although about 90% of the anticipated saving was to be achieved through reducing the growth rate in labour costs, the Department did not develop a comprehensive plan detailing the timing, location, extent and means of attaining these labour cost savings. The Department reports that as the system becomes operational, manpower levels are being frozen or held to growth rates below volume increases and that detailed planning is underway to achieve the desired levels of output in the mechanized plants.

3.51 The Post Office did not adequately measure and report actual MLSS equipment costs in relation to the planned costs in the cost effectiveness studies. As a result management could not react promptly to variances between actual and planned costs.

3.52 Some major assumptions in the cost effectiveness studies were not realized. For example, postal code acceptance was significantly less than forecast. We were unable to ascertain whether the forecast savings were being achieved because the Department had not developed satisfactory procedures to measure and report the effectiveness of the MLSS. The Department has recognized the need to develop cost-effective measurement procedures and it reports that studies to address this problem are underway.

3.53 Public Works - General Purpose Accommodation. The Department of Public Works is responsible for providing general purpose office accommodation to departments and agencies of the Federal Government.

3.54 The primary objective of this activity, according to the 1977-78 Main Estimates is: "to provide departments and agencies of the federal government with accommodation of approved standards of quantity, quality and efficiency at the most economical cost". In our opinion, the Department's existing procedures are not adequate for achieving this objective.

3.55 Our audit disclosed that at present it is impossible to forecast reliably the Government's need for office accommodation. The resolution of this deficiency is beyond the jurisdiction of the

Department. The key factors in accommodation demand are the creation of departments, their size, organization, program changes and location of operating units. The Department of Public Works does not control these factors, is not in a position to predict them and thus is seriously handicapped in planning its activities.

3.56 The Department has developed a computer-based model called the "Real Estate Investment Analysis System" which it uses in assessing the financial implications of alternatives. Although the analytical model itself is good, it does not provide reliable information for the investment decision because of the poor quality of the data used as input.

3.57 At the time of our audit, the Department was only in the preliminary stages of implementing life-cycle costing. Major buildings did not have adequate life-cycle maintenance plans, and such plans were not used in expenditure profiles for investment analysis or as a basis for the budgetary process. We found no evidence that the Department had applied its documented procedures for incorporating operating and maintenance experience into the design of new buildings.

3.58 The Department has no ongoing review process for ensuring that it achieves its objective of providing accommodation of approved standards at the most economical cost. Such a review would include cost and performance comparisons among buildings as well as between government-owned buildings and those in the private sector.

3.59 Public Works - C.D. Howe Building. In 1971, the Department of Public Works was authorized to acquire property at 240 Sparks Street in Ottawa and to prepare plans for constructing an office building. Following January 1973 approval of the design concept by the Deputy Minister and the National Capital Commission, detailed design proceeded. Treasury Board approval for construction and land costs of \$57 million was obtained in February 1974 and the C.D. Howe Building was occupied in 1978.

3.60 In our opinion, the Department did not give due regard to economy in acquiring the C.D. Howe Building. In particular, we found that alternatives were not properly analyzed and presented.

3.61 Instead of paying the full purchase price immediately, the Government is making payments of \$6.1 million per year to the developer for 35 years. The present value of these payments, together with certain land and construction costs paid directly by the Government, is estimated at \$102 million. Based on its original estimates, if the Department itself had let construction contracts, the building would have cost approximately \$90 million on a present value basis, or \$12 million less than the alternative selected. However, because the Department's option definition and analysis process was not followed, its submission to the Treasury Board indicated that the option selected was the most economical. Furthermore, the alternative of continuing to rent office space rather than building new accommodation was not adequately analyzed in the submission to the Treasury Board.

3.62 The capital cost of the C.D. Howe Building is not properly disclosed in the Estimates presented to Parliament. The annual payments to the developer, including the capital portion, will be included in the operating votes of the Department of Public Works in future years. The total estimated capital cost of the building as shown in the Estimates is \$34 million, while the capital cost calculated on a present value basis is \$102 million.

3.63 Transport - Calgary International Airport. The Department of Transport held consultations in 1971 with representatives of the City of Calgary, the Province of Alberta and the air carriers to plan the future development of Calgary Airport. The Department presented a number of

alternatives for consideration, including both the expansion of the existing terminal and the construction of a completely new terminal on a new site. The air carriers expressed strong reservations as to the immediate need for, and concern about the cost of, new terminal facilities. On the other hand, the City of Calgary and the Province of Alberta favoured construction of new facilities as soon as possible.

3.64 In 1973, the Treasury Board approved the construction of a new air terminal complex within the existing airport boundaries. The first phase of the complex, opened in the fall of 1977, was planned to satisfy the 1980 forecast demand. However certain components, for example utilities, were designed to satisfy future development. Three subsequent phases are planned to provide capacity for estimated traffic growth to 1995.

3.65 In our opinion, the Department of Transport did not give due regard to economy in the Calgary Airport project. The written information provided by the Department to the Treasury Board in support of the initial request for approval was inadequate as a basis for evaluating the economy of the proposed project because:

- alternatives to the proposed new complex, such as the modification of the existing terminal, were not presented;
- the concerns expressed by the air carriers were not disclosed;
- financial information was incomplete;
- cost estimates, which were based on conceptual designs, were unrealistic; and
- the Department's written replies to certain questions posed by the Treasury Board officials were incomplete.

However, we understand that the Treasury Board Secretariat was informed orally that the existing terminal could be further modified and might suffice until 1979. Later requests to the Treasury Board for additional project funds did not update financial projections. Thus the impact of the increased capital costs on the future financial viability of the airport was not revealed.

3.66 The Department did not reach agreement with the air carriers on user-pay cost-recovery charges until just prior to the opening of the new terminal. The rates agreed upon will be substantially below those deemed necessary to achieve full cost recovery at the original planned rate. Although the present five-year agreement will be renegotiated upon expiry, there is no guarantee that cost recovery will be achieved over the life of the facilities. In our view, reaching an agreement on cost-recovery charges prior to the start of construction was essential to ensure concern for economy and discourage any unjustified user demands.

3.67 During the course of the project, the size and cost of the air terminal building increased substantially as compared with the original Treasury Board approval of the concept:

- Total size increased by 59% from 452,530 square feet to 720,550 square feet.
- Total cost increased by 255% from approximately \$21.3 million estimated in 1973 to \$75.7 million.

3.68 The Department attributes the increase in the size of the building to:

- changes arising from the preparation of detail design drawings;
- the provision for future utilities to meet the ultimate (1995) terminal development;
- the inclusion of United States preclearance requirements;
- the expansion of holdrooms to accommodate wide-bodied aircraft; and
- the addition of certain office and concession space.

The Calgary terminal is substantially larger than Toronto Terminal II when compared on an area per peak hour passenger basis in the design year of 1980. It is 5.5 times larger than the old terminal which it replaced. The Department advises that comparisons of air terminal buildings can be invalid for various reasons. However, it has been unable to demonstrate by other means that the size of the Calgary terminal is not out of line.

3.69 The increase in cost is attributed by the Department to the development of firm cost estimates based on detailed design drawings, the increase in the size of the terminal due to design changes and inflation. Although the exact impact of inflation is difficult to determine, construction cost indices show an inflation rate of approximately 65% between 1972 and 1977.

3.70 Although the design and construction of air terminal buildings to meet future requirements is a complex task, we are not satisfied that the Department's procedures were adequate to prevent any unnecessary increases in either the cost or size of the Calgary air terminal building. Specifically:

- Extensive authority was delegated to the Western Region without effective review, challenge and control by Headquarters.
- There was no clear acknowledgement by individuals within the administration of responsibility or accountability for the financial viability of the new airport complex once in operation.
- There were inadequate general area and cost criteria, based on comparable Canadian or foreign facilities, against which to monitor the project.
- No cost-benefit or life-cycle analyses were provided in support of major design changes.

3.71 This project and the six that are described below are further discussed in Chapter 19 of this Report as part of the summary of our audit findings in the Department of Transport. There we note improvements in management systems that the Department has introduced. These improvements may prevent recurrences of issues of the types described here. Chapter 19 also contains specific and general departmental comments on our observations and recommendations.

3.72 Transport - Toronto (Malton) International Airport Additions. The Department of Transport received approval in 1973 for a project providing additional capacity at Malton Airport to handle traffic growth up to 1980, prior to opening a second airport in the Toronto area at Pickering. In 1975 the Department cancelled the proposed Pickering Airport thereby changing the perspective of the current expansion at Malton. The project involves the extension and modification of most of the airport facilities including two terminals, a road system, aircraft aprons and utilities plant, as well as new indoor

parking facilities for Terminal II. The project is scheduled for completion in December 1981, although certain facilities such as the extension to Terminal II and adjacent parking facilities are already operational. The total estimated cost is \$159.7 million.

3.73 Our audit did not disclose any major deficiencies in the Malton project. Because the project was undertaken to meet short-range forecasts of traffic growth, the facilities are expected to be well-used as soon as available and an economic use of capital resources should result. However, we observed a number of weaknesses in project planning and control.

- Project objectives made no reference to the Department's "user-pay" policy. Agreement with the airlines on user charges was not reached before project approval except for Air Canada's office accommodation.
- The original estimate of \$54.6 million in 1973, which was based on conceptual designs and did not include highway access and internal road improvements, gave the Treasury Board little indication of the final cost. During the project, design changes arising partly because of the cancellation of the Pickering project had a substantial effect on costs, as did inflation.

3.74 Transport - "R" Class Icebreakers. In 1972, the Treasury Board approved a Department of Transport proposal for construction of a new "R" Class icebreaker at a cost of \$17.0 million to replace the N.B. McLean, then 42 years old. In an effort to expedite the project, tenders for the hull and the propulsion machinery were called separately. None of the tenders for the hull was accepted but a contract was let for the propulsion unit. The Department subsequently proposed that the project be expanded to two "R" Class icebreakers at a total cost of \$60 million. The Treasury Board granted approval in May 1974. After tenders had been received, the Treasury Board, in April 1975, raised the approved ceiling to \$108 million. According to the Department, the increase was mainly due to inflation and to design changes.

3.75 The first ship, the *Pierre Radisson*, was delivered in May 1978. Its sister ship, the *Franklin*, will be delivered in 1979. Both are designed to operate in the St. Lawrence River and Gulf, on the Great Lakes and in the Arctic. Annual operating costs for each ship are estimated at \$2.5 million.

3.76 In our opinion, the Department of Transport did not give due regard to economy in the planning and approval phase of the "R" Class Icebreakers project. The formal documentation of analyses such as anticipated demand and planned service levels was inadequate to support project approval.

3.77 The proposal to acquire the icebreakers did not include a fleet plan to support the need for the two icebreakers. Such a plan should forecast needs for icebreaking services, proposed levels of service, the size of fleet required to provide those levels of service, and the economic benefits that would result. This type of documentation was essential to support the proposal to expand the size of the fleet.

3.78 Early capital cost estimates did not provide a good indication of the eventual cost. In addition, the proposal documents did not adequately analyze the Continuing costs of operating and maintaining the ships and providing them with helicopters.

3.79 Transport - Lightstation Automation. In March 1970, the Treasury Board approved in principle a two-phase project of the Department of Transport for automating 258 manned lightstations

"to improve lighthouse service and to reduce costs throughout the Aids to Navigation Service". In the late 1960s, the lightkeepers' union had initiated bargaining for specific hours of work. Traditionally, hours of work had been undefined as a lightkeeper's presence was required 24 hours a day.

3.80 The 1970 submission to the Treasury Board requested funding of \$14.3 million and identified potential savings of \$6.0 million annually. These savings were to be achieved by reducing the number of lightkeepers by 600, while adding 250 technicians to monitor and maintain the automated system. Automation of operations at each lightstation, was budgeted in 1970 at \$6.6 million with a target completion date of March 1972. The reduction in lightstation personnel was to be achieved by reducing the lightkeeper job to surveillance. Equipment acceptance and organizational problems led to a six-year delay in completing this stage and some lightstations still have not been automated. Installation of a remote monitoring system was budgeted in 1970 at \$7.7 million and was to have been completed by 1978. Treasury Board has now deferred approval of Phase II pending re-evaluation by the Department.

3.81 In our opinion, the Department did not give due regard to economy in the Lightstation Automation project.

3.82 We saw no evidence that the Department examined reasonable alternative ways of implementing the program. On installation, some of the equipment did not function to the satisfaction of lightstation users, primarily commercial fishermen, thereby contributing to delays and cost overruns.

3.83 Approval for the project was based on forecast cost savings to be achieved through a substantial reduction in the number of lightkeepers. However, the Department did not adequately evaluate the feasibility of achieving these reductions. In fact, the small reduction in lightkeeper staff achieved mainly at the beginning of the project has been partly offset by additional requirements for technicians and other support personnel.

3.84 Although the automation project was nation-wide, responsibility for its implementation was delegated to line managers in the regions. Our audit disclosed that regional managers were not held accountable for achieving project objectives on a timely basis within cost limitations.

3.85 The cost of Phase I of the project is now estimated at \$14.2 million including the effects of inflation. However, certain internal costs such as installation labour are not charged to the project. Therefore this estimated cost does not represent the total cost of Phase I.

3.86 Transport Motor Vehicle Test Centre. The Department of Transport is responsible for determining whether motor vehicles and components comply with federal safety standards. To date, the Department has carried out motor vehicle testing using various facilities in Canada and the United States. In June 1974, the Department obtained approval in principle to construct a Canadian motor vehicle test facility at a cost of \$10.3 million. The Motor Vehicle Test Centre is now scheduled for completion by the end of 1978 at an estimated cost of \$25.8 million including inflation.

3.87 In our opinion, the Department of Transport did not give due regard to economy in the planning of the Motor Vehicle Test Centre project.

3.88 The Department did not properly analyze and present alternatives to building a new test facility as a means of carrying out its responsibilities. It commissioned a feasibility study that directed the consultants to assess the design details of the proposed Centre rather than the costs, benefits and alternatives. Its submission to the Treasury Board did not compare the ongoing costs of the proposed

Centre with the costs of alternatives. Estimates now show that, in addition to the capital expenditure of \$25.8 million, it will cost \$1.8 million a year to operate the new Centre. Continuation of the present level of safety testing would cost only \$800,000 a year.

3.89 The Department's submission to the Treasury Board indicated that construction of the Test Centre would increase automotive research and development in Canada, increase the number of technically qualified Canadian automotive personnel and restrict testing expenditures to Canada. It did not compare the effectiveness of the Centre in achieving these benefits with alternative courses of action.

3.90 The Department hopes to recover some portion of the Centre's operating costs through the rental of facilities and personnel to outside users. There was no quantitative analysis of demand or prospective revenues at the time of the original Treasury Board submission. Nor had this analysis been completed by the time of our audit.

3.91 The cost estimate of \$10.3 million included in the submission approved by the Treasury Board in June 1974 was preliminary and did not provide a sound basis for benefit-cost analysis. The Department did not thoroughly reassess the project after design, engineering and cost studies had been completed and the final location at Blainville, Quebec had been selected. The 1974 submission had indicated that a location distant from Ottawa would preclude testing of the Government's National Capital Region motor vehicle fleet and would have other disadvantages.

3.92 Transport - Transport Canada Training Institute. The Training Institute of the Department of Transport, temporarily located in Ottawa, trains air traffic controllers, radio operators, electronic technicians, marine personnel and meteorological technicians. Transportation management courses also are provided. The construction of permanent facilities at Cornwall was approved in principle in 1973 at an estimated cost of \$31.5 million. On the basis of detailed design and taking inflation into account, the Treasury Board raised the expenditure ceiling to \$49.8 million and construction began in 1975. Classes were to begin in September 1978 and relocation from Ottawa is to be completed by the fall of 1979. The capital cost has increased to \$58.0 million. According to the Department, the increase results largely from inflation. In 1980-81, the first full year of operation, forecasts provide for operating costs of \$11.6 million and the use of 308 man-years.

3.93 In our opinion, the Department did not demonstrate due regard for economy in the planning of the Training Institute project. There was inadequate formal documentation of the requirements for in-house training and the analyses of options to meet those requirements.

3.94 The Department did not prepare a formal benefit-cost study of the project, which should have been done in the early planning stages. Moreover, the Department did not adequately document the costs and benefits of the various options by which in-house requirements might have been met. Possible options included, in particular, an incremental building program and phased decentralization from the National Capital Region.

3.95 Training forecasts presented in support of initial project approval did not account for a reduction in demand for Coast Guard cadet training in Cornwall as a result of a decision to retain all cadet training in Nova Scotia. Departmental management indicated however that new demands for other marine training would make up this shortfall and the original forecast was not changed. Also, the forecasts did not express demand in training days or years and did not provide written analyses of course scheduling and facilities usage rates.

3.96 Review procedures within the Department were insufficient to prevent the proposed facilities from increasing in size by 70,000 square feet after approval of the concept. A comprehensive financial report during the planning and estimating phase would have highlighted the cost of the increase.

3.97 Transport - West Coast Vessel Traffic Management System. The Vessel Traffic Management System (VTMS) project of the Department of Transport is intended to reduce the risk of the collision or grounding of vessels and to decrease the risk of pollutants damaging the West Coast environment. The project was proposed as a developmental system to enable the Department's Marine Administration "to innovate and adopt air traffic control systems and techniques to marine traffic as they might apply". The project includes construction of remote radar installations on the lower coast of British Columbia to monitor marine traffic. Through radio and microwave links and automated tracking systems, the Coast Guard will monitor ship movements and provide weather and traffic information to mariners.

3.98 The project, originally approved by the Treasury Board in 1974 at an estimated cost of \$12.0 million, is now expected to cost \$18.0 million due to inflation and design changes. It is expected to be fully operational by the end of 1978.

3.99 Our audit did not disclose any major deficiencies in the West Coast VTMS project. We found, however, some weaknesses in the information supporting approval of the system and in the project cost system. The Department did not clearly define the experimental goals of the project. Possible lower-cost alternatives, such as a ship-to-shore radio system with manual plotting, were not thoroughly explored and documented. Approval was sought, based on rough cost estimates, before engineering studies were completed. The cost system did not report the cost of services that departmental specialists provided, and did not compare detailed costs with estimates for key parts of the project.

3.100 Since this project represents a developmental system, the Marine Administration should conduct a post-project review to ensure maximum benefits are obtained and to assist in planning future vessel traffic management systems.

1978 Report of the Auditor General of Canada - Chapter 4

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Measuring and Increasing Efficiency</H1>

</CENTER>

<HR>

Background

4.1 The growth of governments over the last 15 years has been so substantial that in most countries there is mounting concern for the efficiency of public administration. Many attempts are being made to measure and improve its performance.

4.2 Traditional approaches in both business and government have emphasized direct day-to-day supervision to achieve improved performance. The private sector has led in developing techniques to monitor and improve productivity. Productivity measurement is a relatively new concept in government. Where they have tried to measure the efficiency of their operations, public service managers have concentrated initially on the efficiency or productivity of labour.

4.3 In Canada, the 1962 Report of the (Glassco) Royal Commission on Government Organization generated a new wave of interest in the principles and practices of modern management. The Commission recommended a redefinition of the Treasury Board management role in the Public Service. At the same time there was to be an increase in the responsibility of deputy ministers for managing the resources of their departments. Following government approval of these Glassco recommendations, the Treasury Board Secretariat undertook to develop government-wide policies and guidelines for departments and agencies to use in improving the quality of departmental management.

4.4 In the 1960s, a Planning Programming Budgeting System (PPBS) was developed and introduced. A by-product was a new emphasis on performance measurement for determining the efficiency and effectiveness of programs.

4.5 In 1973, the Treasury Board directed departments and agencies to introduce Operational Performance Measurement Systems (OPMS) where feasible to support 1977-78 Program Forecasts. About 65% of public servants were engaged in activities that the Treasury Board Secretariat judged appropriate for performance measurement. The objectives of OPMS were to:

- support departmental budgets, improve both departmental and Treasury Board control over man-years and demonstrate managerial impact through changes in efficiency; and
- provide information of direct use in the day-to-day management of government programs.

4.6 In 1976, the Treasury Board reaffirmed the 1973 decision to encourage performance measurement. Its Circular No. 1976-25 directed that performance measurement

implementation be accelerated and completed by 1980. The Circular provided clarification of the earlier requirement. It specifically emphasized that program managers need performance measures to aid internal management and resource allocation. If these measures were appropriate, they could be included in support of Program Forecasts. The Treasury Board's performance measurement policy is concerned with measures of efficiency and effectiveness. This Chapter considers only efficiency measurement in labour-intensive operations.

4.7 In 1976, the President of the Treasury Board reported to the House of Commons on the progress, the successes and the problems in implementing performance measurement systems. This report also stated that performance measurement systems had been designed covering the work of 166,000 government employees or 39% of the total authorized man-years.

4.8 In December 1977, the President of the Treasury Board tabled a further report in the House of Commons on performance measurement. This report sought to encourage and assist departments in meeting the 1980 compliance deadline, saying in part:

"It is essential that performance measurement be considered an inherent and indispensable part of the program management process, since it provides the feedback that all managers need to control program operations and to render a proper accounting for the public funds entrusted to them."

4.9 This emphasis on the importance of performance measurement in the Government of Canada lends support to greater recognition of value-for-money accountability throughout the Government. Monitoring and improving the productivity of labour is seldom an easy task; it is perhaps more difficult in the public sector environment than in the private. Nevertheless, the efficient use of labour is a basic responsibility of management. It must receive adequate management attention to satisfy the expectations of the Treasury Board as reflected in its directives and to withstand the audit scrutiny of this Office as called for in the Auditor General Act.

Scope

4.10 For good reasons, early implementation of performance measurement systems tended to focus on repetitive, production or process-type work. This type of work involved many government employees. Output quality, service levels and labour costs were more easily quantified and the measurement technique more easily understood and implemented in such operations.

4.11 Within the general area of efficiency, our early work also has focused on process-type operations such as large clerical groups doing similar work where the productivity of labour should be a significant management concern. We have concentrated on:

- performance measurement systems that have been implemented in response to Treasury Board Directives; and
- any other means management has used to measure, control and improve labour productivity.

Our audits have examined performance measurement in 12 departments and 16 major areas of activity involving about 100,000 man-years. Most major applications of performance measurement in operation in 1978 have been reviewed.

Audit Criteria

4.12 We developed and tested efficiency measurement audit criteria during the early stages of the SPICE project. They are consistent with the Treasury Board's general guidelines on performance measurement, but interpret those guidelines to establish more specific standards for our audits -- standards against which performance measurement and productivity monitoring systems can be assessed. Emphasis is on the use of information in the day-to-day management of operations. The criteria are under continuing review and may be modified in subsequent audit programs.

4.13 Public service managers should monitor their operations and actively seek means of increasing efficiency. This requires measuring and reporting operational performance. Increasing efficiency requires that performance indicators be used to identify possible improvements. The audit criteria we have used to address these and other issues follow.

4.14 Measures of performance should be relevant and accurate.

- Outputs should be well defined and correctly measured. The definitions and measures should be modified to reflect changes in the nature of the output. Proxy measures should be used only if appropriate.
- The characteristics of the output, such as quality and level of service, should be specified clearly. Where feasible, the performance reports should include indicators of these characteristics.
- Inputs should be related to the outputs they produce. Rules for allocating inputs should be appropriate. Adjustments for significant changes in inventories of work in process should be included in the calculations.
- Output and input data should be checked for accuracy and reliability.

4.15 Performance should be adequate in comparison to a standard.

- The standard or base for comparison should be adequate. When appropriate to do so, it should be established by generally acceptable work measurement techniques.
- The standard or base should be established on a consistent basis from one location to another for decentralized operations. It should take local circumstances into account so that meaningful inter-regional comparisons of performance can be made.
- Actual performance levels should be reasonable in comparison with the related standard or base. When standards have been established by Work Measurement, the target for an individual should be 100% of standard. Over a period of time a minimum acceptable group performance should be 80%.

- 4.16 Reports should be tailored to management needs.
- Indicators of performance should be meaningful to program managers. Unweighted aggregation of data on significantly dissimilar units of output should be avoided.
 - Reports should be timely in relation to management needs. They should be summarized and should highlight significant detail.
- 4.17 Performance data should be used to achieve productivity improvement.
- Targets stated either in terms of absolute performance or as gains over some previous period should be set. Performance data should indicate whether the targets are being met and where corrective action is needed. Where historical comparisons form the basis for reporting efficiency levels, additional analysis should be done to indicate the extent to which productivity improvement opportunities exist.
 - Increased efficiency should be systematically sought and evaluated. Recognized techniques such as work measurement and organization and methods analysis should be used for this purpose. Where appropriate, mechanization should be considered. All changes should be evaluated before implementation, including consideration of data on past performance.
 - Performance data should be used to encourage employee groups and managers to improve productivity. The communication to individuals and groups of the performance expected of them is of primary importance. Initiatives such as those suggested by current research on the quality of working life may provide useful means to seek overall productivity improvements.
 - Productivity data should be used in estimating future resource needs. In the budgeting process, performance data should be used to plan improved ways of delivering programs.
- 4.18 Productivity measures and reports should be kept current.
- Data collection and analysis routines should be modified to correct identified defects.
 - Computerization or mechanization projects affecting the labour content of an operation should be recognized and labour productivity indicators revised accordingly.
 - Performance measurement systems should be modified as necessary to reflect program changes arising from new legislation.

Audit Conclusions

4.19 *The Treasury Board Secretariat has provided leadership in defining the issues surrounding performance measurement. Through its directives and compliance reviews, the*

Treasury Board has indicated the importance it attaches to this basic management responsibility.

4.20 *Our examination of 16 performance measurement systems covering about 100,000 man-years in 12 departments revealed only two systems that were considered satisfactory. Most of the performance measurement systems reviewed did not play an important part in the program management process. They generally did not satisfy the information needs of the operating manager who must make the day-to-day decisions required to control productivity.*

4.21 *In most operations we audited, management did not know the actual level of efficiency or how much it might be increased. In most labour-intensive situations, there was insufficient effort to increase productivity.*

Audit Findings

4.22 One of the most important uses of performance data should be to help managers develop better, more efficient means of delivering programs. In practice, the use of performance measures generally has been limited to justifying existing resource levels and in many cases to indicating the need for more staff.

4.23 The Treasury Board Compliance reviews have encouraged departments to develop and implement measures which in the first instance meet the needs of management for day-to-day control rather than those of the Treasury Board for budget control.

4.24 A series of specific problems have come to light during our audits:

- Operational managers generally do not use many of the performance measurement systems installed. Hence they tend to lack any real commitment to these systems and to correcting their weaknesses.
- In many areas where program characteristics justify them, there are still no adequate systems for measuring and reporting operational performance.
- There is often a lack of consistency among regions and among district offices in methods of measuring, in performance standards used, and in management reporting. In these cases, meaningful internal comparisons are not possible.
- Widely dissimilar measures of output are aggregated without correct weighting. The result is misleading indicators of performance.
- The data used in performance measurement systems are often inaccurate. The checking and auditing of information that is susceptible to error is inadequate.
- In most of the departments we examined, there was no way of determining whether operations were attaining a reasonable standard of performance. In these cases, the only reported efficiency indicator available was a comparison of current efficiency with that of a previous period. Since there is no assurance that past performance represents a reasonable level of efficiency, this comparison

alone gives little indication of the extent to which opportunities for improvement exist.

- In those few instances where sufficient data were available to permit a reasonably accurate estimate of labour efficiency, we found it to be below an acceptable level. We obtained our estimates of efficiency levels by comparing the actual time reported with engineered work measurement standards for the operations performed. The standards used for this comparison have international acceptance and are not particularly demanding in terms of employee performance. Our estimated efficiency levels averaged about 65%, which, compared with our criterion of 80%, indicate that there are still significant opportunities for increased productivity. Such increases will only occur through a serious and well-planned improvement program. The potential benefits however are large. For example, if the level of efficiency were increased from 65% to 80% in a department with 10,000 measurable man-years, a cost reduction of the order of \$30 million a year could be anticipated. Expressed another way, a 1% efficiency improvement for the 166,000 man-years judged amenable to performance measurement by the Treasury Board, could represent an annual saving of about \$25 million. Improvements in efficiency of this order typically can be accomplished through careful planning, taking advantage of attrition and non-hiring in the face of increased demand for services.
- In departments with labour-intensive, process-type operations, insufficient attention is being paid to the use of proven techniques leading to increased labour productivity such as organization and methods analysis and the application of appropriate work standards.

Recommendations

4.25 *Departments and agencies should have performance measurement systems in place which meet the needs of departmental managers for controlling their operations. Measures of performance should be used to help managers to plan more cost-effective means of delivering their programs. Where feasible, the measures should also be used to support resource requests in Program Forecasts and Estimates.*

4.26 *Managers of labour-intensive, process-type operations should make greater use of recognized productivity improvement techniques. These include organization and methods analysis and work measurement.*

Case Histories of Performance Measurement in Departments

4.27 The following case histories summarize our examinations of a number of programs where one would reasonably expect to find performance measurement being applied.

4.28 Communications -- Radio Frequency Spectrum Program. The Radio Frequency Spectrum Program of the Department of Communications is intended to improve and extend the use of the radio frequency spectrum to permit the development and growth of radio Communication. Plans for 1977-78 called for 1,056 man-years and expenditures of approximately \$24 million.

4.29 The Department has used its performance measurement system to support Program Forecasts since the 1975-76 Forecast. Our examination of the supporting data raised questions about the validity of these data. For example, some outputs were forecast but corresponding actuals were not reported; those outputs which were both forecast and reported often displayed major variances. Because the Department could not respond fully to our questions we were unable to satisfy ourselves about the validity of the performance data presented. Since the time of the audit, the Department has been taking steps to correct the situation.

4.30 This performance measurement system is also discussed in Chapter 15 of this Report as part of the summary of our audit of the Department of Communications.

4.31 Employment and Immigration -- Immigration and Demographic Policy. The Immigration and Demographic Policy group of the Canada Employment and Immigration Commission employs approximately 2,000 people. The functions of the group include screening and processing immigrants, the examination of people coming into Canada and the settlement of immigrants in this country.

4.32 The Immigration national performance measurement system has generated monthly reports since October 1976. It provides an efficiency index for each region and for the total sector, based on estimated standards.

4.33 We found serious inadequacies in this performance measurement system:

- The standards covered only a part of the work performed at the district and local office level. A multiplying factor ranging from two to four was used to account for the balance of the resources including such things as supervision, travel, idle time and other unmeasured activities. In other words, the actual measured work was only 25% to 50% of the total time allowed. The use of such a large multiplying factor is, in our view, inappropriate and makes historical and inter-regional comparisons of performance unreliable.
- The system did not differentiate between minimum manning locations, those where staff had to be on duty regardless of the workload, and those where staffing levels could be directly related to workload.
- Performance reports did not include quality and level of service indicators.

4.34 We found little evidence to indicate that management was using information provided by the performance measurement system or other productivity improvement techniques to increase the efficiency of labour in this group.

4.35 This performance measurement system and those described in the following three sections are also discussed in Chapter 14 of this Report as part of the summary of our audit of the Canada Employment and Immigration Commission.

4.36 Employment and Immigration -- Benefit Programs. In 1976-77 the Benefit Programs group, formerly known as the Unemployment Insurance Commission, employed more than 10,000 people in providing short-term financial relief and other assistance to workers

eligible under the Unemployment Insurance Act, 1971, 1970-71-72, c. 48. These services are provided through more than 300 district offices across Canada.

4.37 The performance measurement system of the Benefit Programs group, which has been refined over the last 10 years, is by far the most advanced and complete within the Commission and one of the most advanced systems within the Canadian government. This system contains all the essential elements needed for effective performance measurement and has a number of key "operational effectiveness" indicators that enable management to assess the quality and level of service provided. It uses unit costs for assessing overall performance and is able to calculate efficiency at a detailed level using work measurement standards.

4.38 We found few technological weaknesses with performance measurement systems in this group. We did, however, observe shortcomings in managing the productivity improvement effort, with the result that performance measurement information is not used as extensively as it might be.

4.39 The considerable Headquarters effort that has gone into developing work measurement standards has not been used to the fullest extent by the regions. Although some regions used the Commission's national standards to calculate actual levels of efficiency, others developed their own "standards" based on historical performance. Some regions did not use standards at all. Consequently, one could not readily compare regional efficiency levels or establish national efficiency targets.

4.40 As an example of the lack of uniform standards, a sample of the larger offices in the Ontario Region reported an average efficiency in 1977 of 95%, against the Ontario historical standards. Against the work measurement standards developed by National Headquarters, the performance of the same offices over the same period appears to have been approximately 65%. This would indicate that the opportunity exists to achieve substantial benefits from improvement in efficiency.

4.41 No discernible efforts had been made and no clearly identifiable group existed to initiate and monitor productivity improvements. Improved management and clearer direction could substantially improve the effectiveness of the performance measurement and improvement effort.

4.42 Employment and Immigration -- Central Index. The primary function of the Central Index of the Canada Employment and Immigration Commission is processing, issuing and maintaining Social Insurance numbers for Canadian citizens and landed immigrants. Applications for Social Insurance cards are received in Ottawa or through the local offices of the Commission. In 1977, a total staff of 236 issued 1.2 million new and 350,000 replacement cards. Most Central Index functions are clerical, repetitive and easily measurable with performance measurement techniques. Our review of the management controls in Central Index concentrated on aspects that have an impact on operational efficiency.

4.43 Central Index management has made substantial efforts to manage the production and registry operations efficiently. It has developed work standards for certain activities and uses them, although only to a limited extent, to monitor work performance. Adjustments in operating procedures since 1975 have not been accompanied by adjustments in the standards and, consequently, the standards affected have simply been discarded. Only 30%

of the measurable activities were being measured. In our opinion the extension and upgrading of the work measurement program could result in improved productivity.

4.44 For some key sections we compared the actual time reported with standards which we developed for this purpose from internationally accepted standard data. Based on this comparison, we estimated productivity for Central Index was about 65%. This indicates that there are still significant opportunities for improving efficiency.

4.45 Employment and Immigration -- Labour Market Policy. The Labour Market Policy group of the Canada Employment and Immigration Commission employs approximately 11,000 people in delivering employment services to the public, including counselling, testing, training and referrals to job openings.

4.46 The Labour Market Policy group has substantial areas that are amenable to performance measurement. Yet only some regions were reporting manpower utilization, while the national performance measurement activities included only volume counts such as the number of registrations, placements, etc. Consequently, national performance could not be measured and reported on a regular basis.

4.47 The data collected were essentially for supporting man-year budgetary requests. Our audit revealed a number of problems with the data, including:

- Standards were based on estimates which had not been validated through the use of work measurement.
- The data contained major errors. For example, the number of placements during 1977-78 accumulated from the monthly performance measurement data was 30% below the number reported by another monitoring system of the Commission for the same period.
- Output category definitions were not clearly understood and were interpreted differently by different users.
- An unnecessarily large number of volume counts were collected.

As a result, the data had little credibility and limited use as a basis for efficiency control. This Group had little information suitable for guiding and assisting a productivity improvement effort.

4.48 External Affairs -- Passport Office. The Passport Office issues travel documents for Canadian citizens and certain permanent residents of Canada. The passports are issued by mail from Ottawa and increasingly by over-the-counter service at seven regional offices. Employing 387 people, with an operating budget of \$8.7 million, the Office issued about 745,000 passports in 1977-78.

4.49 The Passport Office's efficiency depends on its ability to plan and respond swiftly to the seasonally fluctuating demand for services. Permanent and temporary employees and overtime work must be used appropriately to hold the cost of issuing a passport to a minimum while providing an acceptable level of service. We audited the Passport Office's management controls and, in particular, examined and tested the suitability of the time standards it uses to control the efficiency of operations.

4.50 The Passport Office has made substantial efforts to manage its operations efficiently. Cost reductions have been achieved. Correction of the performance measurement weaknesses disclosed in our audit could add to these efforts.

4.51 The Passport Office recently updated its work standards. Our investigation found weaknesses in the technique used. An audit of 10 time standards, which account for 36% of measured work, revealed that these standards were overstated compared to engineered time standards. Correcting such standards will not by itself change the actual efficiency of the Passport Office. It will, however, change the precision of measurement of the actual level of efficiency, thereby making possible more reliable identification of additional opportunities for productivity improvement.

4.52 In co-operation with the Department and based on the audited standards, we estimated the productivity of measured work against engineered time standards. The analysis showed that actual productivity was close to a reasonable level as stated in our audit criteria earlier in this Chapter.

4.53 Indian Affairs and Northern Development -- National Parks. The Estimates of the Department of Indian Affairs and Northern Development included 2,736 man-years for operating and maintaining Canada's 28 national parks in the year ended March 31, 1978. Salary costs totalled \$28 million.

4.54 Our audit included an examination of the availability and use of suitable procedures to measure and report the efficiency of operations where appropriate. Our main finding in this area was that management lacked adequate means to measure efficiency. The existing management information systems were not an effective information base for controlling and evaluating performance. National Parks had no system-wide, approved standards or base against which the performance of its preservation and recreation activities could be planned, measured and evaluated. It is possible to develop standards for many activities and management itself recognizes that this can be done (e.g., for warden service and maintenance activities).

4.55 Without performance standards, it is difficult for management to evaluate resource requests consistently since yardsticks do not exist against which these requests could be assessed. Thus there was no objective statistical base for assuring that the annual operations and maintenance estimates were at the proper level (\$58 million for 1977-78). Park superintendents had no basis to quantify and justify additional resources while park assets were expanding with larger campgrounds, new golf courses, additional trails, etc.

4.56 National Defence -- Facilities Maintenance. Construction Engineering, a major activity within the Canadian Armed Forces, maintains 32 bases and 28 stations across Canada involving some 35,000 facilities. In 1975-76, \$126 million and 6,500 man-years were used on facilities maintenance which includes the repair and upkeep of buildings, grounds and works.

4.57 Studies in the early 1970s sought to determine the feasibility of performance measurement in the facilities maintenance function. In 1975, Air Transport Command tested a proposed measurement system and concluded that effectiveness measurement was feasible but efficiency measurement was not. The United States Department of Defense has developed engineered performance standards which have been adopted by industry. The implementation of these standards has increased productivity in the Department of Defense real property

maintenance operations, demonstrating the major cost savings available through effective work measurement systems. The potential savings that the Canadian Department could realize by introducing efficiency measurement have been largely ignored. Since the audit was completed, the Department has continued its development and testing of procedures for measuring effectiveness of facilities maintenance. These procedures will be brought into general use during 1978. A further study of engineered performance standards is being made in 1978.

4.58 Departmental reporting systems accumulated costs for facilities that were widely dissimilar in age, size and type of construction and condition. The resulting unit cost data did not allow management to make meaningful comparisons. A more homogeneous grouping of these facilities would have enabled management to make more effective use of the data in controlling costs. The Department has informed us that during 1978 all bases are being provided with a work control and cost system which when co-ordinated with the existing property records system will permit timely display of costs including those we recommended.

4.59 National Health and Welfare -- Income Security. The Department of National Health and Welfare employs more than 2,000 people in administering Family Allowances and Old Age Security. Our audit focused exclusively on the Income Security performance measurement system. We did not address other important efficiency issues such as efforts to improve productivity.

4.60 Our review of the performance measurement system revealed only minor control weaknesses. We found evidence of management support for the system and use of performance information in monitoring the efficiency of operations. Management was also active in maintaining the system's relevance and validity in the face of legislative and operational changes. In the last 18 months they have modified it to improve further the validity and format of the information reported.

4.61 The Income Security performance measurement is also discussed in Chapter 17 of this Report as part of the summary of our audit of the Department of National Health and Welfare.

4.62 National Revenue, Customs and Excise Commercial Operations. The Customs and Excise program assesses, collects and controls duties and taxes on imported and domestically produced goods and exercises control over the international movement of persons and goods. In 1976 the Treasury Board Secretariat estimated that approximately 6,500 of the Department's 10,016 man-years could be covered by efficiency measures.

4.63 Since 1970 the Department has been actively engaged in defining performance measures. Standard operating procedures have been developed for most of the tasks involved in performing the Customs role. For each standard operating procedure, also termed a subordinate indicator, the Department has developed engineered performance standards. It also has developed a single performance indicator for the Examination and Control of Commercial Operations sub-activity -- the time per commercial entry. However, comparison of the value of this performance indicator to that of the base year is not meaningful since the mix of the subordinate indicators from which it is formed may change over time. Thus the value of the indicator and the reported performance may change although efficiency may or may not have changed.

4.64 Although the Department made an effort to record and communicate performance measurement data, it achieved only limited success. Managers generally made little use of such data because the form and content of the reports did not facilitate detailed resource allocation decisions. Consequently, management personnel at all levels, from the ports to Headquarters were not receiving adequate information on the efficiency of the operations for which they were responsible.

4.65 The lack of success of the program to measure operational performance can be attributed to many factors, including:

- the failure to keep the work standards current;
- the failure to establish a means of adjusting the performance indicator to reflect the changes in the mix of the subordinate indicators; and
- the questionable validity and utility of the management information data.

4.66 The Department has recognized the above issues and is attempting to address them as it reconsiders its approach to performance measurement.

4.67 These performance measurement systems are also discussed in Chapter 18 of this Report as part of the summary of our audit of the Department.

4.68 National Revenue, Taxation -- Enforcement Activity. The enforcement activity in the Department of National Revenue, Taxation is concerned with ensuring compliance with the law. The sub-activities we reviewed use about 5,000 man-years in carrying out enforcement operations on over 12 million personal tax returns and more than 300,000 corporate tax returns.

4.69 The Department carried out a performance measurement pilot study in 1970 which produced preliminary data for the 1972-73 Program Forecast. Major tax reform in 1972 nullified these initial performance measurement efforts and significantly changed the enforcement work.

4.70 The Department next introduced a complex computerized time and production reporting system. In 1976, the Department's Consulting and Statistics Division reviewed the system and made recommendations to correct various problems. This review reflects the Department's concern to improve its performance measurement system. The review reported several major shortcomings including:

- The system contained some information that was obviously incorrect.
- Inconsistencies existed between indicated efficiency trends and reality. Data portrayed efficiency improvement while narratives suggested that efficiency was declining due to increasing complexity.

4.71 In 1977, Treasury Board officers conducted a compliance review of the performance measurement system. Their findings reinforced the Department's conclusions and specifically stated that:

- The performance measures in the Program Forecast did not provide adequate support for resource requests.
- Information was not presented in a suitable format to allow performance measurement of the enforcement activity.

4.72 Our observations indicated that unexplained discrepancies and a lack of historical continuity characterized measures used in the 1977-78 Program Forecast. These, together with the known high error rates, have seriously undermined confidence in the system. The Department has experienced repeated difficulties in establishing a base year against which to compare subsequent performance. It is continuing its efforts to correct and improve its performance measurement deficiencies.

4.73 Post Office -- Mail Processing. The Post Office Department employs a large portion of the public service man-years engaged in operational processes amenable to productivity measurement. According to the Program Forecast in 1976-77, 44,000 of the Department's 56,000 man-years were covered by productivity measures. The majority of these man-years are employed in sorting and delivering mail.

4.74 We focused our audit on the performance measures used to control Mail Processing productivity. We did not review the performance measures of the Letter Carrier activity. We understand that indicators in the Department's performance measurement system are no longer used in controlling the productivity of letter carriers. However, carrier walks are established based on engineered time standards.

4.75 In our opinion, the national performance measurement system and related regional systems displayed significant weaknesses in providing productivity information to management. The measurement of mail processing productivity was oversimplified, with the result that the impact of cost-reduction efforts such as mechanization could not be adequately determined. The Department recognizes cost-effective volume measurement as a fundamental problem to be solved and is conducting studies seeking solutions to this problem.

4.76 Inaccurate data led to overstatements of productivity levels. In addition, the unreliability of manpower data in the national system lessened its usefulness as a basis for resource allocation.

4.77 Combining performance data for mechanized divisions with those of manual divisions in mechanized plants and with those of offices using only manual sorting reduced the data's usefulness. Merging the two kinds of data prevented the application of standards such as those used in the Department's cost effectiveness study for mechanization.

4.78 Output measures of mail processing activities were oversimplified. Each parcel, letter or piece of unaddressed householder mail was counted as one piece of mail, even though each used significantly different amounts of human and capital resources. Since the relative quantities of these mail types were changing, the result was inaccurate computations of productivity and productivity trends in both national and regional performance reports. The mix change featured an increasing proportion of householder mail and therefore resulted in the overstatement of productivity.

4.79 Engineered standards, once the bulwark of performance management in mail processing, no longer play a role in the Department's performance measurement systems either nationally or regionally.

4.80 Royal Canadian Mounted Police Training Program. The Royal Canadian Mounted Police employs more than 550 instructors, administrators and support staff in basic and field recruit training, in-service operational skills training and development of administrative and management abilities. Depot Division, with a staff of about 100, is a large training component within the Force, providing recruit training for more than 1,000 trainees in some years.

4.81 Our audit of Depot Division disclosed that the existing management information systems did not provide for the regular assessment of the extent to which instructors and facilities were being used. During our visit to Depot Division, we calculated the current week's utilization and found that it ranged from 27% to 40% for instructors and from 19% to 66% for various facilities. Over the full 1976-77 year, average facility utilization approximated 64%. It appeared that low use from year to year was attributable mainly to budgetary constraints and within each year to fluctuations in recruit levels. If utilization were regularly measured, the information could prompt further effort to balance recruit intake with the deployment of training resources and staff.

4.82 Secretary of State of Canada -- Translation Bureau. During the year ended March 31, 1977, the Bureau employed approximately 1,800 people and incurred operating costs of \$36.6 million. According to production reports, the Bureau translated more than 230 million words during this period.

4.83 The counting of the number of words translated is intended to be carried out in accordance with standard counting procedures. Our tests of the accuracy of word counting indicated the approved procedures were not always followed. Also, the procedures themselves were inadequate in some branches. These two problems resulted in a significant overstatement of production and of productivity, distorting productivity comparisons with external organizations and productivity reports to the Treasury Board Secretariat.

4.84 Production rates were significantly below the Bureau's own production standards. We did not verify the validity of the Bureau's standards, but cost comparisons with outside translation services indicated that they were achievable. We estimated that if the Bureau had achieved its production standards during the year ended March 31, 1977, it could have translated the same number of words for \$5.4 million less and thereby made available to the Government an additional translation capacity amounting to 58 million words.

4.85 Veterans Affairs -- Treatment Services. The Department of Veterans Affairs and related agencies administer compensation and other benefits to veterans. Administration operating and capital expenditures in 1977-78 totalled \$205 million including salary costs of \$120 million for about 7,400 man-years. Our departmental review of management controls included an assessment of the performance measurement activities in Veterans Services, Treatment Services and Veterans Land Administration. The greatest opportunity for improved performance measurement was in the Treatment Services Program which had administration and capital expenditures in 1977-78 of \$155 million including salary costs of \$80 million for about 5,100 man-years.

4.86 At the time of our audit, Treatment Services had a system for measuring and assessing hospital performance. That system did not lend itself to comparative analyses with external hospital systems in Canada or elsewhere, as the outputs from the DVA control and reporting system were not consistent with the hospital performance measurement systems that have been generally accepted across Canada and in the United States. The DVA system did, however, permit assessment of the performance of individual hospitals as well as performance comparisons among facilities within the DVA group of hospitals. Our study findings showed that the available data were not used by management to assess performance, to monitor standards of patient care, to analyze different facilities, or to take appropriate corrective action.

4.87 The Department's facilities for active treatment were also used to provide chronic and domiciliary care. The costs of providing this care were more than twice those in facilities outside the Department which specialize in chronic and domiciliary care. We estimate that provision of the required chronic and domiciliary care in facilities designed for that purpose could yield savings of approximately \$19 million a year. The hospital transfer program could contribute to realizing these potential savings.

4.88 In addition, the average number of days patients stay for active treatment care in the Department's hospitals was more than twice as high as for patients with similar illnesses and in similar age groups in hospitals across Canada. We recognize that there is a longstanding policy of preferred treatment for veterans. However, if average patient-stay could be reduced to 25% above the national average, a further \$15 million of savings could be realized. Here again, the hospital transfer program could be instrumental in generating a portion of these potential savings.

1978 Report of the Auditor General of Canada - Chapter 5

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Evaluating Effectiveness</H1>
</CENTER>

<HR>

Background

5.1 The effectiveness of public programs forms the core of value for money in government. New programs will often need support from funds diverted from less important existing programs or from programs whose objectives can be achieved through less costly means. Public programs have a propensity to become self-perpetuating. Once launched, they tend to continue unchecked except for annual budget increments and occasional shifts in regulation. This must be overcome if value is to be had from the public moneys concerned. Economy and efficiency may be principal issues of management, but the achievement of desirable program goals outranks them in importance. Although there may be some merit in doing the right thing badly, there is none whatever in doing the wrong thing well.

5.2 The introduction of Planning Programming and Budgeting Systems (PPBS) in the 1960s heralded a new emphasis on program evaluation in the Federal Government. The aim was to improve resource allocation and make planning and budgeting more realistic in terms of the achievement of stipulated program goals and government expenditure priorities. Measurement of program effects was described as the cornerstone of the PPBS structure. But little direction or technical assistance was provided at that time to departments to enable them to undertake satisfactory evaluations.

5.3 In 1974, the Treasury Board Secretariat decided to examine program evaluation work in each of the departments. Its review was intended primarily to examine organizational arrangements rather than the kind and quality of work being carried out. Approximately 3,500 man-years were identified as being associated with the planning and evaluation function. Included in that number were 267 senior executive positions. A significant finding of that study was

"that most departments had not attempted to organize the program evaluation function, at least as a specialized function distinct from program management, even though man-years and in many cases executive resources had been allocated to departments for this function."

5.4 This finding led to a second study by the Treasury Board Secretariat in 1976 which, in contrast to the previous organization-based study, reviewed the nature of existing evaluation activities wherever they existed in a department. This study arrived at a similar conclusion: "Departmental responses indicate a limited breadth of activity related to evaluating program effectiveness." These findings are included in the report entitled Departmental Evaluation Activity in the Federal Government, issued by the Planning Branch of the Treasury Board Secretariat in December 1976.

5.5 During the last year the Treasury Board took a fresh initiative by issuing Circular No. 77-47 entitled Evaluation of Programs by Departments and Agencies. Related guidelines were circulated for comment during 1978. The Treasury Board policy covers evaluation of both efficiency and effectiveness. This Chapter reviews only procedures to measure and report effectiveness.

5.6 During the SPICE project, we have had continuing consultation on program evaluation with the Treasury Board Secretariat and more recently, with the Office of the Comptroller General. As part of the SPICE project, the Office has reviewed the available program evaluation literature and retained professionals in the field as advisers and consultants. Senior representatives of the Office have made research trips to the United States, Great Britain and Sweden.

5.7 Some countries, such as the United States, have invested significantly more effort than Canada in measuring program effectiveness. At the same time, it can be said that the recent emphasis the Government of Canada has placed on program evaluation could, if developed and sustained, put it among the leaders in the field.

Scope

5.8 Under Section 7(2)(e) of the Auditor General Act, the Auditor General is required to call Parliament's attention to cases in which he has observed that "satisfactory procedures have not been established to measure and report the effectiveness of programs where such procedures could appropriately and reasonably be implemented." In our value-for-money audits, we assessed the extent to which selected programs were amenable to effectiveness evaluation. We reviewed program objectives and intended effects for clarity and the likelihood that they would be achieved by program activities. Program goals and effects which could reasonably be measured were identified. Where departmental evaluations had been done, we assessed the measurement and reporting procedures.

5.9 Effectiveness measurement reviews were conducted for 23 programs in 18 departments. These programs cover a wide range of social and economic government activities.

Audit Criteria

5.10 From our research on the state of the art in effectiveness evaluation in Canada and other Countries, we developed basic positions that in turn contributed to our audit criteria. Our basic positions are:

- There is a perception that program evaluation is difficult, expensive and time-consuming. Many managers believe that the effectiveness of their programs cannot be measured. Although there are limitations in what can be measured, practical means are available for at least partial measurement of the impact of most major programs.
- As a general rule, one does not have to approach the limits of the state of the art to plan and carry out useful evaluations. The problem is not so much a lack of advanced technology but failure to apply recognized principles and well-tested techniques where appropriate and reasonable.

- Technically-flawed measurements of effectiveness are at least useless and perhaps misleading. Decision makers must have full confidence in the credibility of any analysis before they can give it serious consideration.

5.11 The forthcoming Treasury Board Guidelines on Program Evaluation (recently circulated by the Comptroller General for comment) require that each program be subject to appropriate evaluation on a regular basis. We support the Treasury Board's position on this policy, which anticipates a variety of evaluation methods depending on the practicability of evaluation in any given program. Although there will always be elements of subjective judgment in program evaluation, we also believe that maximum use should be made of recognized evaluation methodology to measure the impact of Federal Government programs. The following audit criteria are consistent with the state of the art and with the Treasury Board Guidelines.

5.12 Program objectives and effects should be specified as precisely as possible.

- Value for money implies an ability to ascertain program accomplishments. Within practical limits, program objectives should be clearly defined in ways that will enhance their evaluability. The specification of precise objectives is necessary to address the important question: How will Parliament know if programs are worth their cost?

5.13 Program objectives and effects which can be measured should be identified.

- The foundation of every decision to carry out effectiveness evaluation should be an "evaluability assessment." The evaluability assessment involves a series of steps which clarify the logic linking a program's activities to its objectives and anticipated effects. The purpose is to determine which goals and effects might be considered in an effectiveness evaluation.
- The first step is to describe the program. Information is gathered and a model is developed which defines the program's activities, objectives and effects as well as the underlying assumptions about how the objectives are to be achieved by program activities. The model is then critically examined to identify the program objectives and effects that can be both measured and realistically achieved. Taken together, the goals and effects that are measurable and their cause and effect relationship to program activities constitute the framework for analysis. Management can then initiate evaluations to determine the extent to which the program is effective.

5.14 Procedures to measure program effectiveness should reflect the state of the art and be cost-justified.

- The outcomes of programs should be measured in every case where measurement is possible, practical and cost-justified.
- Departments and agencies should use the best available techniques in measuring and reporting the effectiveness of their programs. The state of the art is global, not solely Canadian. Departments should be well-informed about evaluation activities in other jurisdictions and should take advantage of that information in planning their own evaluations.

- 5.15 The results of effectiveness measurement should be reported.
- Reports on program effectiveness should be provided to management, the Government and Parliament in a manner and frequency consistent with the recipient's decision-making responsibilities.
 - Such reports should include any significant qualifications about the limitations and reliability of the information.
- 5.16 Evaluations should be used to increase program effectiveness.
- Departments should develop a comprehensive program evaluation plan that ensures the timely assessment of the accomplishments of major programs.
 - Evaluations should lead to improved understanding of the program and its impact. Such insights may lead to decisions to modify aspects of the program or to add new elements to the process of program delivery. They are an essential input to decisions on the future of programs.

Audit Conclusion

5.17 *A review of 23 programs in 18 departments has disclosed few successful attempts to evaluate the effectiveness of programs. The scope and quality of effectiveness evaluation will have to be increased significantly before management, the Government and Parliament, each with its respective interests, can be reasonably informed on the achievements of public programs.*

Audit Findings

5.18 Over the years, departmental accomplishments in effectiveness evaluation and use of appropriate evaluation techniques have fallen short of reasonable expectations in at least three respects -- the amount of effort being made to conduct appropriate evaluations, the quality of evaluations conducted and the reporting and use of study findings.

5.19 Our examinations identified two departments which have measured and reported significant program outcomes. Both of these evaluation efforts are marked by technical deficiencies that affect their reliability.

5.20 Our examinations indicate that, by and large, program objectives are stated in only general terms. Program outcomes that can be measured have not been identified. The lack of precise objectives contributes to the notion that effectiveness evaluation is excessively difficult. When our staff, in co-operation with program managers, conducted program evaluability assessments, imprecise objectives were noted in every case. Clarification of these objectives led to the identification of some measurable outcomes in every program. These situations have been discussed with departmental officials and in general we have agreement that more could and should be done to measure effectiveness reliably.

5.21 Where departments had taken steps to measure program effectiveness, the measurements often exhibited serious shortcomings. In some cases, doubt has been cast on the accuracy or reliability of findings. For example, surveys had response rates that were too

low -- or questioned too few people to begin with to ensure that findings would be valid. Questions asked in some surveys were ambiguous and confusing, making the meaning of the answers obtained uncertain.

5.22 Our examination of existing measurement and reporting procedures may appear to expose the departments which have carried out evaluations to a more detailed examination and criticism than those departments which have not attempted such evaluations. It should be clear that it is a less serious failure of management to have conducted effectiveness studies that are weak than to have conducted no evaluations where it would have been reasonable and appropriate to do so.

5.23 Evaluation reports on program effectiveness provided to senior management generally do not contain qualifications about their limitations and reliability. The communication of such reports to Parliament is rare. Submissions to Parliament on the effectiveness of the Regional Development Incentives Act are noteworthy because they represent a seldom seen example of public reporting in response to legislative requirement.

Recommendations

5.24 *Information on program effectiveness should be forwarded to decision makers in a manner and frequency consistent with the recipient's decision-making responsibilities.*

5.25 *Departments and agencies should clearly specify program objectives and effects, identify evaluable outcomes and measure these evaluable outcomes as precisely as possible.*

5.26 *Effectiveness evaluation procedures should reflect the state of the art in Canada and elsewhere and their use should be cost-justified.*

Case Histories of Program Evaluations

5.27 This section presents case histories of attempts to measure and report program effectiveness and instances where attempts have not been made where it would have been appropriate and reasonable to do so. These illustrate the audit findings described above.

5.28 Agriculture -- Agricultural Stabilization and Agricultural Products Boards. The Agricultural Stabilization Board (ASB) administers legislation which guarantees a minimum support level for certain farm products, such as cattle, hogs, industrial milk and for other products when designated. During 1976-77 ASB spent \$28.7 million on agricultural stabilization, excluding dairy products. The Agricultural Products Board (APB) can buy, sell and stock farm products to support stabilization goals. Its programs are an alternative to direct subsidy payments. The cost for 1976-77 was \$866,000. The same individuals act as members of both Boards.

5.29 The Boards have established a series of program objectives. The more significant are to guarantee farmers a reasonable return on labour and investment and to protect them from sharp falls in market prices. Agricultural support programs seek to help farmers confidently make long-term production decisions without stimulating over-production or interfering in the production and marketing decisions of individual producers.

5.30 We found that completed programs were not satisfactorily reviewed by management to determine if such objectives were met. The Department of Agriculture routinely monitors statistics on certain agricultural crops and products. Additional economic research was carried out using new data submitted by farmers in their applications to the Boards. The Department should analyze these data more completely to assess whether stabilization objectives have been met and should review additional important factors such as:

- the concerns and complaints of producers;
- the appropriateness of the eligibility criteria for participation; and
- the long-term economic prospects of producing certain types of agricultural products given price and production trends in Canada and world-wide.

More systematic evaluation of the impact of completed stabilization programs would enable management to improve future programs and to determine the extent to which value for money has been received.

5.31 Consumer and Corporate Affairs Consumer Affairs Program: Regulatory Activities. The development of consumer protection regulatory legislation and its nation-wide enforcement is the responsibility of the three regulatory activities (Legal Metrology, Consumer Fraud Protection and Product Safety) of the Consumer Affairs Program of the Department of Consumer and Corporate Affairs. Generally, the objectives and sub-objectives as described to us by the activity managers were clear, although most were not documented or formally approved. While the majority of sub-objectives were stated in measurable terms, in two cases the ultimate activity objectives were stated in non-measurable terms such as "... enhancing the ability of the consumer to differentiate between product and/or service choices" and "to justify and enhance consumer confidence in the equity of transactions."

5.32 To their credit, management of two of the three regulatory activities had attempted to develop and use several measures of program effectiveness. One significant indicator of program effectiveness in Legal Metrology and Consumer Fraud Protection was the reduction of economic loss to buyers or sellers due to inaccurate meters, inaccurate weighing devices and misrepresented products. The Department had been unable to measure this program effect reliably but considerable progress was being made in the development of more reliable measures.

5.33 Product Safety is responsible for keeping hazardous products off the market. Management did not have an accurate picture of the nature of the problem in Canada. The Department was, however, monitoring accident data in the United States to identify potential problems not brought to its attention by its field inspectors or other means. It has considered the establishment of a computerized, nation-wide accident reporting system to capture these data. However, recent pilot studies by the Department have indicated that useful information can be obtained by contracting with selected hospitals for periodic reporting on the number and nature of product-related injuries.

5.34 Employment and Immigration -- Canada Manpower Training Program. The Canada Manpower Training Program operates under the Adult Occupational Training Act, R.S., c. A-2. The Act states that the objectives of the Program are to:

- increase the earning capacity of adults; and
- increase their opportunities for employment.

To meet these objectives, the Federal Government purchases institutional classroom training, involving both basic courses and courses in various skill areas, and selects and refers applicants for training. The Government also encourages industry to conduct its own on-the-job training by partially subsidizing wages paid to employees undergoing industrial training. The cost of the program, including contributions and capital expenditures for both institutional and industrial training, reached \$550 million in 1976-77 and was estimated at \$590 million for 1977-78.

5.35 In 1977, the Canada Employment and Immigration Commission conducted a major review of the Canada Manpower Training Program jointly with the Treasury Board Secretariat and the Department of Finance. The review provided useful analysis of many issues within manpower training, including a reassessment of the Program's goals. It determined the extent to which each goal was precise and realistic. As a result, program management discarded vague goals adopted over the years and reoriented the Program toward the goals set out in the Adult Occupational Training Act, namely, to increase earnings and improve employability.

5.36 The Commission conducted effectiveness evaluations on the extent to which the Canada Manpower Training Program increased employability and earnings. These studies lacked the necessary checks to ensure the reliability and validity of the findings. National follow-up studies, for example, were not adequately tested for reliability of the questionnaires or accuracy of the responses. Field follow-up studies were incomplete because they lacked the information necessary to assess and account for the impact of training. Departmental publications referred to benefit-cost analysis results as a prime indicator of the value of the Program, but the 1977 joint study identified numerous methodological weaknesses in the analysis, making the validity of the results questionable. The Commission has decided to reduce its reliance on benefit-cost studies in determining the worth of this Program.

5.37 The Commission had not evaluated the effectiveness of its industrial training program since 1974. An evaluation conducted then relied on two surveys of trainees, each marked by an extremely low response rate, 25% in one and 13% in the other. Such low response rates preclude reliable inferences about program effectiveness.

5.38 The Commission had not carried out systematic research on the effects of providing income support training allowances to all institutional trainees. Thus it did not know whether people undertook training just to obtain the allowance or to what extent the allowance was vital to permit some people to take training. In 1977 the cost of the allowances was over \$200 million.

5.39 Counsellors play a key role in referring candidates to training courses. The Commission had undertaken little research to assess the referral process so it could develop improved guidelines for assessing the potential of applicants. Finally, the Commission had not checked whether its course purchases from individual provinces were consistent with projections of occupational needs within those provinces.

5.40 The Canada Manpower Training Program is also discussed in Chapter 14 of this Report as part of the summary of our audit of the Commission.

5.41 Employment and Immigration Local Initiatives Program. Until its end in 1977, the Local Initiatives Program (LIP) was one of several job creation programs sponsored by the Canada Employment and Immigration Commission. After it was officially discontinued, many of its features were carried forward in the Canada Works Program.

5.42 LIP funds were disbursed during periods of high unemployment to individuals, organizations and municipalities which submitted proposals expected to meet the Program's two objectives: (1) job creation and (2) community betterment. In all, the cost of the Program was close to \$1,000 million over six years.

5.43 The Commission directed considerable effort to evaluating the extent to which LIP was achieving its goals. Evaluation of accomplishments in terms of the job creation objective was generally satisfactory. A major portion of these evaluation efforts was directed to the evaluation of the goal of "community betterment" which was never clearly defined. As a result, the Commission funded effectiveness evaluation studies attempting to measure not only community attitudes and perceptions but also the effect of LIP in reducing a wide range of social problems such as crime, alcoholism and child abuse. The likelihood that LIP could reduce such problems was low to begin with, given the limited scale of the LIP projects. However, such studies could be justified as exploratory surveys as long as they did not attempt to draw conclusions on the effectiveness of the Program.

5.44 The terms of reference of the effectiveness evaluation studies were overly ambitious in relation to the funds provided and unrealistic compared to the results that the studies could reasonably be expected to produce.

5.45 Technical shortcomings in the evaluation studies seriously affected the reliability of some of the results. For example, a survey designed to determine whether LIP had increased earned income among participants did not include a sufficient number of interviews to detect reliably whether the predicted effect had been achieved. Further, some of the survey questions were poorly worded and could have resulted in ambiguous answers.

5.46 The Commission had no formal procedures to identify, evaluate and document weaknesses and limitations about the LIP evaluation work. For example, unqualified statements on the effectiveness of LIP were reported in official documentation and were used as a basis for subsequent evaluations.

5.47 LIP is also discussed in Chapter 14 of this Report as part of the summary of our audit of the Commission.

5.48 Indian Affairs and Northern Development - Education Activity. The Department of Indian Affairs and Northern Development is responsible for the education of status Indian children, either in federal schools or in non-Indian communities under agreements with the provinces. The 1977-78 Main Estimates provided \$236 million for Indian education, of which \$33.3 million was for capital expenditures. The main emphasis of the education capital program is on the construction of new schools.

5.49 In the early 1970s the Department experimented with the idea of employing local native labour in the school construction program. The employment of native people was expected to:

- increase support from parents for the education program;
- create jobs for native people in their own communities; and
- provide on-the-job training.

5.50 The job creation and training objectives were not translated into goals such as the number of weeks of work to be provided and the level of skill to be achieved. On some projects, the Department of Public Works, which directed the construction of the schools for Indian Affairs and Northern Development, made extensive use of non-native tradesmen and sub-contractors. Although most of the projects have been completed for some time, there has been no objective evaluation of the effectiveness of these projects in providing employment and training to native people.

5.51 Industry, Trade and Commerce Machinery Branch. One of the major concerns of the Department of Industry, Trade and Commerce is the Trade Industrial Program established to fulfil the objective of achieving "efficient and sustained growth in the production and trade of Canadian goods and services." A series of department-wide programs are designed to provide assistance to firms in pursuit of the objectives of the Trade-Industrial Program. Seven branches accomplish program delivery, each focusing on one sector of Canadian industry. Our audit concentrated on the Machinery Branch which in 1976-77 administered grants and contributions of about \$10 million and recommended duty remissions amounting to \$200 million.

552 Our audit disclosed that sector objectives and corresponding Branch strategies are not clearly stated. The Branch has not specified these objectives in operational terms such as:

- the nature and degree of the change which should be occurring in specified characteristics of the sector;
- the kinds and numbers of firms that should be encouraged to use assistance;
- the characteristics of assisted firms that should be changed and the extent of planned changes; and
- the forms and amounts of assistance that should be provided to the various kinds and numbers of firms.

5.53 Most department-wide programs for delivery of assistance to the Machinery Sector through the Machinery Branch have not been evaluated for their effectiveness. As a result, the Branch is provided with limited data to help plan and evaluate sector objectives and strategies. The Department needs to give increased emphasis to its efforts to evaluate the effectiveness of these major programs.

5.54 The Branch also should monitor the immediate effects of its sectoral advice and service activities. Operational effectiveness indicators would provide improved insight into the extent to which it is accomplishing its objectives. It could maintain records to:

- monitor actual results against quantified objectives;
- determine the proportion of trade post inquiries passed on to firms that have been acted on and associated with export sales;
- determine to what extent advice to firms concerning rationalization, specialization, technological changes, unique developments, etc., are associated with corresponding action and beneficial results; and
- analyze the extent to which sundry development project advice to firms, buyers, U.S. parent companies and provincial and federal government departments achieves anticipated results.

5.55 Management controls in the Machinery Branch are also discussed in Chapter 16 of this Report as part of the summary of our audit of the Department of Industry, Trade and Commerce.

5.56 Labour Research and Program Development. The Research and Program Development (RPD) Activity of the Department of Labour has two primary functions: providing information and research services and developing policies and programs. These functions are aimed at improving Canadian industrial relations and employment standards. For 1976-77, it was allocated 262 man-years and an operating budget of \$7.2 million, about one-third and one-quarter respectively of the Department's budget.

5.57 In March 1976, RPD was assigned prime responsibility for conducting evaluations of the effectiveness of the Department's programs. Notwithstanding the mandate for conducting program evaluations and commitments to do so, RPD was concentrating on implementing priority projects and was deferring the question of measuring program effects until new departmental programs were operational. Ignoring evaluation requirements during program development, when many options are still open, reduces the possibility of choosing the best program structures. It also seriously reduces the possibility that the programs will be structured to facilitate measurement of outcomes and that appropriate data will be captured.

5.58 Certain of the Department's programs include inspection activities aimed at ensuring compliance with specific labour standards. Information on level of compliance is certainly vital for program management, but falls short of what is required to measure program effectiveness. As of June 1977, the Department did not have satisfactory procedures to determine the effectiveness of its existing or proposed programs.

5.59 National Revenue, Customs and Excise Examination and Control of Commercial Operations. The objective of the Department of National Revenue, Customs and Excise, as stated in the Estimates, is "to assess, collect and control duties and taxes on imported and domestically produced goods, and exercise control over international movements of persons and goods." Like the customs systems in other countries, the Canadian system relies in the first instance on importers, their agents, carriers and others to correctly assess the amount of duty and taxes owed to the Crown and to comply with all relevant laws, regulations and procedures.

5.60 Under the self-assessment system, those responsible for controlling commercial imports should know:

- the amount of revenue from import duties and taxes which with 100% compliance theoretically could be collected by Customs, compared to that actually received; and
- the Department's effectiveness in enforcing other Acts which are not revenue oriented but play an important role in protecting Canadian industry and society.

5.61 These factors are central to the measurement of the Examination and Control of Commercial Operations sub-activity of Customs. Although the Department established objectives for the Customs sub-program, it did not develop effectiveness indicators for the sub-activity and the major operations it comprises such as examination, assessment and investigation.

5.62 The Department designed systems and procedures to verify the accuracy of revenue actually collected with respect to individual importations and to help detect undeclared revenue which would otherwise not be collected. However, the Department did not measure what portion of revenue potentially available was in fact being collected. Our audit, conducted with the assistance of departmental staff, demonstrated that practical means are available to measure the effectiveness of the assessment function. Similar tests could be applied to measure the effectiveness of the Department's other operations, such as examination of goods, investigations, the post-audit carrier system and drawbacks and refunds.

5.63 Departmental measurement of program effectiveness is also discussed in Chapter 18 of this Report as part of the summary of our audit of the Department.

5.64 National Revenue, Taxation - Enforcement Activity. The objectives of the Enforcement Activity of the Department of National Revenue, Taxation are to encourage voluntary compliance and deter tax evasion while administering the tax law fairly. An immediate outcome of the enforcement of tax law is the identification of undeclared income on which taxes are due. To the extent that these taxes are collected, they reduce the tax burden on all Canadians.

5.65 To assess how effective its enforcement activities are, the Department needs a reliable estimate of the extent of non-compliance by taxpayers. Some work has been undertaken which is being updated and extended, principally through the introduction of a Compliance Measurement System. In 1977 the Department publicly estimated non-compliance for the 1974 tax year at \$1,700 million, 6.8% of tax revenue collected. Amounts equal to \$200 million were subsequently collected. The remaining balance includes an estimated \$1,200 million of uncollected taxes associated with self-employed taxpayers and \$300 million of uncollected taxes associated with corporate taxpayers. Most projections are described as underestimated. No estimate is made for a further category of non-compliance, people who do not file a return. Even partial information in this area should be useful to the Department. We acknowledge that such estimates are difficult and at the limit of the state of the art. Nevertheless we recommend the Department explore the possibilities.

5.66 There is little information on the extent to which additional undeclared tax revenue could be economically collected. The Department has made no attempts to assess the full extent of the impact of its enforcement activity on taxpayer behaviour.

5.67 Regional Economic Expansion - Regional Development Incentives Act. The purpose of the Regional Development Incentives Act, R.S., c. R-3, (RDIA) is to attract investment into relatively slow growth areas within Canada and thereby create improved opportunities for productive employment. To accomplish this, the Department of Regional Economic Expansion provides:

- incentive contributions and loan guarantees to manufacturing and processing industries to establish, expand, or modernize their operations in designated regions; and
- loan guarantees to certain types of projects in the service industries.

The expenditure on contributions in 1976-77 was \$81.7 million. The contingent liability created in the same year by virtue of loan guarantees was \$900,000.

5.68 The Department has not established quantified program objectives to implement the RDIA. For example, annual investment and job creation goals for selected growth areas would assist program managers to focus on program outcomes. Goals should reflect an analysis of disparities among regions and the role of the program in the context of the economic development activities of the Department.

5.69 As required by the Act, the Department forwards monthly reports to Parliament on anticipated jobs and approved capital costs. These reports give an order-of-magnitude estimate of the impact of the RDIA. At the time of our study in July 1977, the Department was revising the monthly report and developing an annual report to provide cumulative statistics since the inception of the program. These monthly and annual reports provide useful information to program managers and more importantly constitute a noteworthy example of publicly reporting program outcomes on a regular basis.

5.70 These reports could be improved without incurring substantial additional costs. For example, the reports could show:

- the number of jobs created categorized by salary levels;
- net additions to the Canadian economy, aggregating anticipated capital costs and jobs attracted from other countries; and
- trends in stability of created jobs such as jobs disappearing as businesses fail and additional jobs created as companies expand without further assistance.

5.71 The Department conducts specific technical studies of limited scope which provide operating managers with insights into aspects of program effectiveness. It published a comprehensive assessment of the effectiveness of the program in 1973. About \$340 million has been committed or expended by the program since then. An updated and improved comprehensive assessment is overdue.

5.72 The 1973 study reviewed the activities of the Department in providing incentives to industry. A major focus of the review was to determine the number of jobs and investments that would not have been created without RDIA and to relate these to the costs of the program. Because the program was relatively new, few projects had reached completion and data were limited. Two evaluation approaches were used. The first estimated the proportion of RDIA assisted jobs which would have been created without the program and subtracted those from the total of RDIA funded jobs. Estimates were based to a considerable extent on judgment. In future studies, the subjective component should be reduced.

5.73 The second approach estimated the manufacturing investment which would have occurred in the absence of RDIA. These estimates were compared to the actual manufacturing investment with the RDIA program in operation. No details of this work were reported. Hence, no judgment as to the validity of the work can be made. Future reports should provide adequate technical explanation to allow a reader to make informed judgments.

5.74 Summary extracts of the study were widely circulated within the Federal Government and made available to the general public.

5.75 Secretary of State of Canada -- Bilingualism Development Program. The Bilingualism Development Program of the Department of the Secretary of State of Canada has been in operation for more than eight years. Through transfer payments, the Program helps support bilingualism in education, in non-federal public administration and in the private sector. It also provides grants for language research. The 1977-78 Estimates included transfer payments of \$154 million, a growth exceeding 200% during the preceding seven years largely due to increased participation by the provinces and higher costs of education. Since 1971 over \$750 million has been spent on this Program. Our audit focused mainly on the non-discretionary payments which amount to 80% of total transfer payments under the Program.

5.76 In general, the existing managerial controls over non-discretionary payments were insufficient both in terms of quality and quantity to ensure appropriate measurement and reporting of program effectiveness. Significant portions of the Bilingualism Development Program can be measured in effectiveness terms, yet our audit revealed that few attempts had been made to conduct effectiveness evaluations. For example, the Department did not know the number of Canadians who would take advantage of further opportunities to learn the other official language, or the number who would welcome the chance to educate their children in the official language of their choice. Without this information, the effectiveness of the bilingualism in education aspect of the Program cannot be measured. There are no requirements in the federal-provincial agreements for provinces to submit to the Branch their plans and priorities for bilingualism in education. As a result, it is difficult for the Branch to develop strategies appropriate to each province for promoting bilingualism.

5.77 For non-discretionary payments, the federal-provincial agreements covering bilingualism development state:

"It is understood that with respect to all of the measures described, the provincial governments will undertake appropriate monitoring and evaluative activities and that the results will be made available to the Federal Government."

The federal-provincial agreements do not specify exactly how the monitoring and evaluation should be carried out. As a result, what few evaluation reports are received from the provinces

are not adequate for the Department's purposes. In light of the agreements, the Federal Government should provide the provincial governments with advice as to what constitutes "appropriate monitoring and evaluative activities". There should also be some direction as to how the results of evaluation should be reported.

5.78 Solicitor General -- Federal Parole System. The Federal Parole System, forming part of the Correctional Services Program of the Department of the Solicitor General, comprises the National Parole Board and the National Parole Service. The Parole Board is responsible for making decisions on whether to grant or deny parole and on whether to revoke parole where there is a serious violation. The Parole Service is responsible for preparing case material that the Board uses in making parole decisions and for supervising inmates released on parole. Currently, the Parole Board uses 251 man-years and the Parole Service 837 man-years. The Board's expenditure for 1977-78 was \$5.4 million, that of the Parole Service \$21.2 million.

5.79 Our audit revealed that the Parole Board was not in a position to evaluate its effectiveness since it has not specified criteria for assessing the quality and consistency of its decisions. The Parole Act, R.S., c. P-2, provides the only reference to parole-granting by specifying the following three broad criteria:

- The inmate has derived maximum benefit from imprisonment.
- The reform and rehabilitation of the inmate will be aided by the grant of parole.
- Parole would not constitute undue risk to society.

5.80 The Parole Board had not, however, developed operational definitions for these criteria to enable them to be used in practice. A study of the National Board, published by the Law Reform Commission in 1976, drew attention to the need for the Board to establish a "set of clear, consistent and explicit criteria for parole decision-making." The usefulness of such specific criteria has been demonstrated in some jurisdictions in the United States, where the federal and some state parole boards make decisions that are routinely assessed against explicit published criteria. These criteria incorporate considerations of the severity of the crime and likelihood of parole success.

5.81 The Parole Board has moved in this direction by developing and testing a model to predict the likelihood of recidivism. However, the Board has not used the prediction model along with other possible considerations, such as those noted above to develop criteria for assessing the quality and consistency of their decisions. The extent of adherence to these criteria would serve as a direct measure of consistency and an indirect measure of the Parole Board's effectiveness.

5.82 The Parole Service provides supervision to parolees on day parole and full parole. Parole supervision is provided by Parole Service staff and contracted agencies (e.g., the John Howard Society, the Elizabeth Fry Society, the St. Leonards Society, Provincial Probation Services, etc.).

5.83 Extensive studies have been undertaken in the United States to investigate the effectiveness of parole supervision programs. These studies indicate that the post-incarceration criminal behaviour of inmates is not significantly affected by type and extent of parole supervision. The Department of the Solicitor General provided major financial support and co-

operation for a study by a Canadian university on federal inmates released on parole in Ontario. This study reached similar conclusions. The Department had not assessed the implications of the findings of these studies for the value of parole in Canada.

5.84 Veterans Affairs Veterans Services and Treatment Services Programs. The Department of Veterans Affairs provides assistance and social and medical services to veterans with the aim of ensuring that they are self-sufficient and participative members of the community.

5.85 We found that the Department had not translated its broad legislative mandate into more specific program goals. This was particularly evident in the Veterans Services Program, which administers matters relating to the social welfare of veterans. The nature of this Program has altered substantially since its inception. At the outset, it primarily featured social benefit payments to veterans. It was later enlarged to include counselling and recently evolved toward a geriatric/gerontology specialization. Information was being accumulated in an attempt to determine the nature and extent of the social and economic needs of client groups. Exploratory work was also being carried out to assess the effectiveness of the benefits provided. We concluded, however, that much more intensive study would be required to define client needs before the effectiveness of the Program could be measured satisfactorily.

5.86 The Treatment Services Program includes the operation of hospitals and veterans homes. Effectiveness evaluation of this Program could reasonably and appropriately be carried out on the basis of comparing performance of departmental hospitals with that of provincial and other hospitals with respect to level, costs and quality of care. Our study found that such evaluations were not being carried out.

1978 Report of the Auditor General of Canada - Chapter 6

```
<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Improving the Financial Information Parliament Receives</H1>
</CENTER>
<IMG SRC="../../graphics/linegra3.gif" WIDTH=100% ALT="line">
<HR>
```

Introduction

6.1 Purpose. My last three annual Reports called for action to improve the usefulness of information on spending plans that the Government presents to Parliament in the Estimates. Little has been done although the Public Accounts Committee strongly supported the calls and the Treasury Board Secretariat promised to take action. One problem contributing to the delay is the need for determining first what information Parliament needs. It is a prime problem.

6.2 The Government is responsible for the form and content of the Estimates. We assume, however, that in exercising this responsibility the Government wants the views of parliamentarians. This Chapter seeks to assist in the discussion by: (1) stating my perception of how the Estimates serve Parliament and Government alike; (2) demonstrating, through examples, how the Estimates could be made more useful by including information already available in departments; (3) citing some actions necessary in the longer run to improve the quality of the information now available. We recommend no single or standard solution, but demonstrate options available to Parliament and the Government. Any improvements in the Estimates will automatically improve the Public Accounts, especially Volume II, since it reports the degree of compliance with the spending plans contained in the Estimates. Action to improve the Estimates might well begin by improving the Public Accounts since this would ensure that reliable information can be provided before it is introduced in the Estimates.

6.3 In the coming year my Office will focus attention on Volume II of the Public Accounts to determine whether information Parliament receives on actual expenditures can be improved beyond that available in the Estimates on prospective expenditures. We will review in detail the financial and other information available to departmental management to determine what portion might be useful to Parliament. The Public Accounts now mirror the Estimates, providing expenditure data in comparable form but containing little additional information. The information on prospective expenditures that can be provided in the Estimates is obviously limited. However, Parliament can be much better informed retrospectively on actual expenditures, as well as on the results they achieve.

6.4 Particular attention will be paid to the non-financial data necessary to assess whether expenditures are made with due regard to value obtained. Such information, when now provided to Parliament, is rarely tied to financial data obtained from the books of account. The natural tendency of departments to submit information that will portray them in the most favourable light needs to be restrained by tying financial figures to the official accounts and by making non-financial data as reliable as the financial amounts included in the Public Accounts.

6.5 Each department should submit in Volume II of the Public Accounts information that is as informative to Members of Parliament as that provided to shareholders in annual

reports in the private sector. Practices now vary greatly. Departments tend to regard Volume II as a product of the Receiver General, accept its highly standardized form, and do little to tell Parliament effectively what they have done. Improvements may significantly expand the size of Volume II, require separate volumes for each ministry and eliminate the need for separate annual reports. All these matters will be thoroughly examined in the coming year.

6.6 Scope of demonstration project. This project deals primarily with the Estimates and is based on the recent financial management and control studies and on the review this year of information available in:

- the Department of Agriculture and three Crown corporations reporting to its Minister,
- the Department of Energy, Mines and Resources,
- the Department of Public Works,
- the Department of National Health and Welfare,
- the Royal Canadian Mounted Police, and
- the St. Lawrence Seaway Authority.

6.7 This Chapter presents the results of this year's work by illustrating government-wide opportunities to improve the Estimates. The various Exhibits are drawn from more comprehensive illustrations of how selected programs of several departments might be presented to Parliament. Appendix D presents illustrative Estimates for Agriculture. Illustrative Estimates for the other departments and agencies will be available to the Public Accounts Committee and other interested parties. Although prepared from information obtained from the departments concerned, departmental officials were not asked to endorse the illustrations. They are intended only to portray some possible alternatives.

6.8 This Office neither audited the information departments now provide in their Estimates nor reviewed the budgeting procedures used to derive it. Nor did we analyze the accounting systems to ensure that they could produce accurate and reliable information on the same basis as the Estimates. The Audit Office, however, plans to extend its audit efforts in these areas to ensure that the information in the Estimates is reliable and that the information in the Public Accounts is comparable to the Estimates.

6.9 Key issue. The essential issue is the need for improved accountability. This demands more effective monitoring of government departments and agencies by Parliament and would involve:

- greater disclosure to Parliament by departments of what they seek to achieve in the current year, how they plan to do it, who will be responsible for doing it, and how they plan to measure success;
- greater emphasis on the reliability of information in the Estimates and comparable information in Public Accounts;

- identification by the Comptroller General, on behalf of the Government, of the information to be provided in both the Estimates and Public Accounts and action to ensure its integrity and comparability; and
- greater clarity concerning the nature of expenditures that appropriations are intended to cover, so my Office can discharge the responsibility assigned to me of calling attention to every case where an appropriation was exceeded or was applied to a purpose or in a manner not authorized by Parliament.

6.10 Significance of illustrations. In assessing the Estimates as an integral part of a financial control system, this Office could suggest a single model. It could also suggest standards at various levels of detail and at various stages of the process - from the methodology used to generate the Estimates to the specific wording and form of schedules used in the Blue Book. However, such a model or standards might cause departments to believe that this would be the only approach. This might also inhibit informative disclosure by forcing activities and operations of a very heterogeneous nature into a single general format. We designed the illustrations to show more informative and useful forms of presentation, deliberately tailoring them to each department's unique programs to show that rigid adherence to a single suggested form is not intended.

6.11 The overriding principle for evaluating the examples is whether they give the user relevant information in a manner that makes the most efficient use of his time. Simplicity and focused attention are essential to attain these goals.

6.12 Although changes to the Estimates have to be approached on an integrated basis, various components are discussed individually to facilitate their consideration.

Significance of the Estimates for Control of the Public Purse

6.13 Parliamentary control. Observations and recommendations in this and in past annual Reports reflect the unique requirements of the parliamentary process. It may therefore be useful at the outset to summarize the way the form of the Estimates influences the work of Parliament.

6.14 Parliament requires information for two forms of analysis of the spending plans of the Government:

(a) To assess the proposed allocation of resources, it must know the various objectives of the Government and the level of funding allocated to each, as well as historical and projected spending for comparison purposes.

(b) To evaluate the potential for achievement in carrying out these plans, it must know what programs and activities the funds are to be used for, the types of resources required and how responsibility is to be assigned.

6.15 Each perspective may require quite different information. Limited summary information can satisfy the first. The second requires that the information be specific enough to provide proper yardsticks for assessing subsequent performance.

6.16 Parliamentary processes traditionally have been based on rules designed to permit Parliament to obtain "redress of grievances" before the appropriation of funds - a principle dating back to Magna Carta. Procedures and the rules of Supply gave ample opportunity to question the responsible minister, delay passage of the Estimates, and defeat the Government if it did not have the confidence of the House. Except for this ultimate sanction, it was clearly understood that the Government, not Parliament, governed since under the British North America Act only the Government can introduce or amend an appropriation bill. Since Parliament can only accept or reduce an appropriation request, it is not surprising that the parliamentary review was of a general nature and did not require much detail in the Estimates.

6.17 Significant changes in the rules of Supply in 1969 removed a number of procedural steps that enabled parliamentarians to delay or prevent the granting of supply. These changes shifted much of the responsibility for Estimates review to an expanded structure of 15 Standing Committees of the House of Commons, replacing the previous review by a Committee of the Whole; linked the rules of Supply to the calendar (June 30 being the date by which the Main Estimates are deemed to be approved); and provided opposition parties with a specific number of days, during the Estimates consideration period, to initiate motions of non-confidence. Thus, the opportunity to defeat the government of the day was separated from the process of reviewing its detailed plans.

6.18 The 1969 changes gave Members of Parliament a better opportunity for organized and informed analysis of the Estimates through membership on any one of 15 Standing Committees of the House of Commons. Unfortunately, the improvements in the form of the Estimates in 1969 did not sufficiently recognize that such analysis requires significantly greater information than Parliament needed when it was reviewing the Estimates in Committee of the Whole.

6.19 Our proposals assume that in considering changes to the form of the Estimates all Members of Parliament will wish to make the procedures agreed to in 1969 more effective; and that the Estimates should disclose the Government's plans in a way that permits them to be understood, debated and compared to past performance, thereby establishing with greater certainty accountability for the fiscal year concerned.

6.20 Because the Estimates review takes place just before or during the time programs are being executed, extensive information is needed on expenditures in the current and preceding years. This cannot be left for the Public Accounts where any review takes place almost a year after transactions occur. The Public Accounts, nevertheless, provide the best opportunity to assess actual performance in relation to plans. The cycle would be complete if departments and agencies were required to report and explain in the Public Accounts how their actual performance compared to the plans.

6.21 Effective and constructive participation by parliamentarians in the Estimates review process depends directly on the quality of information they receive. It is appropriate to also consider whether the present processes can be improved in other ways.

6.22 Different Standing Committees of Parliament review the Estimates and the Public Accounts. Review would be facilitated if the same Standing Committees reviewed the Estimates, Public Accounts and the portions of our Report dealing with the departments with which each is concerned. Parliament might then wish to consider giving a committee, such as the Miscellaneous Estimates Committee or the Public Accounts Committee, responsibility for

looking at government-wide issues contained in the Estimates, as well as in the Public Accounts and the annual Report of this Office. Alternatively, one Committee, the Miscellaneous Estimates Committee, could deal with the Estimates in summary or consolidated form and the other, the Public Accounts Committee, with comparable data on actual expenditures including explanations of variances from the Estimates.

6.23 Managerial control. My 1976 Report identified what we believe are the key elements in controlling the public purse. One was the need for a financial plan. The Report stated that:

"... instead of being the cornerstone of the system for managing and controlling financial resources, it (planning) is a separate process primarily designed from the departmental viewpoint to obtain additional resources and from the central viewpoint to allocate available resources. The resulting documents are inadequate as action plans since they do not describe what is to be done, who is to do it and what resources are required for the purpose. Thus, managers lack the direction and commitment required and there is no means of holding them accountable by comparing their actual performance in relation to plans."

The Estimates should be the tip of the iceberg, the small visible part of the whole that rests on the detailed plans of managers throughout government. Ideally, they should constitute a relatively concise summary of plans managers make to attain the Government's objectives within the resources made available.

6.24 More specific disclosure of plans to Parliament is likely to result in improved financial management and control throughout government. The Estimates would then:

- permit the exercise of expenditure control by comparing actual performance to that planned;
- make financial reports more meaningful by comparing financial and non-financial data to the plan;
- provide a basis for financial controls over individual transactions by permitting those responsible to relate the transactions to an overall plan; and
- set internal targets against which actual results can be compared through the audit or evaluation process.

6.25 In summary, improving financial management in government depends on improving the Estimates. Better and more detailed Estimates will lead to improved financial and operational planning at all levels of management. Improved planning, in turn, will lead to better expenditure control, financial reporting and exercise of all other controls at every level.

Structure of the Estimates Document

6.26 Evolution. The form of the Estimates has evolved over the years:

- In 1930, it was possible to summarize the entire Estimates of some \$391 million by departments on two small pages. The 335 votes of that year were supported

by details that showed the exact salary requirements by number and grade, with all funding being divided between salaries and contingencies.

- By 1938, the Estimates had changed so that the requirements of departments were shown by branches and divisions.
- In 1951, the Estimates were extensively revised. The presentation of votes by departments, branches and divisions continued, but these were subdivided into separate votes for "operations and maintenance," "capital," and "grants and contributions." This greatly expanded vote structure was supported by a "details of service" section listing manpower by number and grade and explaining all expenditures by 22 standard objects and some special objects. This presentation, which with some modifications prevailed until 1970-71, was the ultimate in standardization.

6.27 The Glassco Commission recommended in 1961 that the presentation of the Estimates by 495 votes "... be reduced and all cost elements of individual programmes be consolidated within the same vote". It also recommended that the Estimates "be prepared on the basis of programmes of activity and not by standard objects of expenditure".

6.28 Although the number of votes was reduced earlier, the form of the Estimates did not change drastically until 1970-71 when the present form was adopted. In summary, it is composed of:

- a number of government-wide summaries showing details by department;
- a summary of all programs and votes under a minister's authority;
- an appropriation summary for each program;
- supporting narratives stating objectives and giving program descriptions; and
- supporting tables showing details by activities, by objects of expenditure, by manpower and, if material, by capital projects and grants and contributions.

Any details by organizational units below the departmental level, except where programs themselves were defined on an organizational basis, disappeared and the object-of-expenditure and manpower data were significantly summarized.

6.29 One or several volumes? Changes have progressively increased the size of the Blue Book as the Treasury Board has added to the information previously provided. The 1978-79 Estimates has 1,271 pages. If implemented, the suggestions we are advancing will further increase the document's size.

6.30 This illustrates a basic dilemma confronting modern governments. The size and variety of their activities require presentation in a generalized, summary manner if the information is to be contained in a single volume. Such summary data, however, limit meaningful analysis. The processes, operations and projects being performed must be disclosed, costed and related to the results expected before the data become precise enough to be useful. As a result, there may be a need for the Estimates to be split into two components: a

volume on government-wide spending, concentrating on the proposed global amounts and a second volume or volumes on departments and agencies, showing how they plan to manage the funds.

6.31 Summary volume. Beginning with the Estimates for the 1970-71 fiscal year, the Treasury Board included at the front of the document a narrative explaining material contained in the Estimates and a number of new summary tables presenting various types of information on a government-wide basis. The explanatory preface and the summary tables now occupy the first 95 pages of the document. This initiative constituted a useful addition but the sandstorm of figures without explanation has lessened its value. The tables are simply tabulations of data contained in the departmental sections.

6.32 A much more concise volume should be prepared to give Parliament summary information for use in debates covering the entire operations of the Government, the size of expenditures relative to previous years and to the level of spending in the private sector and the relative distribution of scarce resources among competing objectives. Such a summary volume should be directed to all members of Parliament and should include the government-wide data contained in the front of the present volume, the appropriations to be included in the Appropriation Acts, additional summaries and highlights, and explanatory data of the type now included in the Treasury Board publication "How your Tax Dollar is Spent". Although it can be argued that this information is already available and therefore need not be included with the Estimates, in our opinion such a comprehensive volume would be useful for both parliamentarians and the public.

6.33 There are many other opportunities for improving the summary material, such as:

- providing historical summaries covering a five-year period, (the last two years, the Estimates year and projecting the Estimates year for the next two years);
- deleting departmental and program detail from government-wide summary tables to focus attention better on significant totals;
- using graphic instead of tabular presentations where the grouping and use of the data do not require accounting precision; and
- adding summary narrative statements highlighting significant government-wide developments.

6.34 Additional analytical tables would enhance parliamentary and public understanding of the Government's expenditure plans. Because the amounts grouped are not identified below the program level, the present functional analyses are unduly restricted. Programs and activities of several departments often contribute to several objectives of the government. The presentation, in a government-wide summary volume, of total costs for the complete range of government activities on a number of subjects, for example expenditures in the North or for native peoples, regardless of the departments contributing to the total effort, would represent a useful addition. Summary data for the general information of Parliament does not have to be restricted to that obtained from the present pyramidal build-up of costs.

6.35 Departmental volumes. The second volume or volumes should be designed to satisfy the needs of members of Standing Committees or others who want to know about the

programs of a single department or ministry. This would provide a much more convenient document for members, and could contain data significant for a particular program. Separate documents would be more convenient for many users of the Estimates, including members of the department itself. Departments could then assume greater responsibility for the information and add material now included in various other documents, such as annual reports and departmental policy statements. Departments would feel more accountable for the information under these circumstances.

6.36 Relationship among volumes. The illustrations shown for several departmental programs suggest a number of other opportunities for improving the form of the Estimates, as distinct from their content, including increased use of graphs and narratives to direct the user's attention to significant matters the detailed tabulations contain. The second volume should provide information about programs in other departments that contribute to attaining the objectives for which a given department has primary responsibility. For example, in the Department of Transport volume these cross-departmental relationships would show that the Marine Program of the Department of Public Works must be taken into account in assessing the government's expenditures on Marine Transportation. As another example, the shared cost programs of the Department of National Health and Welfare cannot be assessed without taking account of related expenditure contained in the Department of Finance Estimates.

6.37 Organization of Estimates material. Ideally, the Estimates document should begin with a clear overview of summary data and progressively "explode" with ever-increasing detail so that the user may pursue his particular interest to a point of satisfaction. The concept is illustrated in Exhibit 6.1.

Exhibit not available

6.38 This concept should be applied to the departmental volumes. The departmental Estimates should start with some department-wide summaries, followed by summary material at the program level, then broken down to the activity, object or responsibility level, the lowest suggested in most of the illustrations. It would also be useful to show how the information was built up within a department, even though the actual data are not disclosed at this level of detail, so that users can pursue their interests on an exception basis by asking questions during a standing committee's review.

6.39 The order of presenting the data should reflect the order in which resource allocation decisions were made. If a department carries out the same activities in decentralized responsibility centres across the country, the analysis should be presented first by activity, with responsibility being a secondary disclosure, so that performance among responsibility centres across the country may be compared. By contrast, if a responsibility centre is involved in an operation unique to it, it is better to start with the responsibility centre and, as a secondary analysis, show the activities it carries out. These alternatives are illustrated in Exhibits 6.7 and 6.9.

Exhibits not available

6.40 Generally, the illustrations have avoided a matrix type of presentation. Although such presentations summarize data on a single page, they do not lead the reader to adopt an analytical approach that leads to the most appropriate conclusion.

6.41 Degree of standardization. The departmental illustrations have much in common, although different approaches have been illustrated. This not only demonstrates that several options are available, but also that different styles and detail may be appropriate for different programs.

6.42 The Estimates document is now highly standardized, with similar schedules for departments and programs. It contains only one level of detail of activity, object and manpower data for all programs. For some programs, this breakdown may be all that is required, but for most a greater level of detail is required to reveal a program's sub-activities and resource requirements. Many of the illustrations, by going one level lower, provide significantly more useful information. In larger programs, it may be necessary to go to a second, third or even lower level of detail before the data become specific enough to satisfy analytical needs.

6.43 The summary volume must be standard since it is a government-wide presentation. The supporting volumes should be tailored to tell parliamentarians what they need to know about individual departments and their programs.

6.44 An illustration of carrying standardization to the extreme is the present practice of showing supporting data on continuing authorities, such as for revolving funds or working capital advances, in a manner similar to lapsing appropriations. The user is shown expenditure and revenue data, but has no means of knowing that the expenditure figures represent accrued costs, not cash disbursements as in other programs. Additionally, the amount of the advance that is expected to be outstanding is not disclosed, even though parliamentary control is exercised by limiting the amount of the advance that may be outstanding at any time.

6.45 Presentation of comparative data. One area where standardization is both desirable and feasible is in selecting the year-to-year comparative data. The Estimates now make two types of comparisons. All tables, except for government-wide summaries, compare three years: the Estimates year, the current year and the previous year. The summary tables compare the Estimates for the new year with the Estimates for the current year and actual expenditures for the previous year. Supporting tables show comparisons among the Estimates for the new year, forecast expenditures for the current year and actual expenditures for the previous year.

6.46 The Report on the Study of the Accounts of Canada, which the Treasury Board prepared, this Office endorsed and the Public Accounts Committee approved, recommended a different approach. The comparisons proposed in the Study of the Accounts are illustrated in the suggested appropriation summary for the Health Care Program, Exhibit 6.2 which shows:

- amounts to be voted for Estimates year;
- amounts voted for current year;
- the changes between the two;
- estimated expenditures for Estimates year;
- forecast expenditures for current year; and
- actual expenditures for previous year.

This approach highlights for Parliament what new authority is to be voted and permits departments to distinguish between authorities granted and their forecast of what will be used. This recognizes that funds will lapse when a department can spend up to the limit but not go beyond it. It also permits programs having continuing authority, such as those with revolving funds to show that authority granted bears little relationship to funds advanced. We believe these are the most meaningful types of comparisons, but other choices are illustrated.

Exhibit not available

6.47 The column which provides the best bench mark or guide is the current year's forecast. Previous year data may be too out-of-date to be fully comparable. The current year's forecast may indicate what is needed in the future by showing what is needed now. The accuracy of these forecasts will improve if they are given greater importance. Although the narratives and highlights should focus on the Estimates year, they should justify the Estimates' requirements in relation to the current year's forecasts.

Content of Estimates

6.48 Departmental and program summary information. The only summary information now presented for individual departments, as distinct from government-wide summaries, is a General Summary table which lists by program the votes and statutory items for which a Minister is responsible (including those of Crown corporations). The table compares the proposed estimates with the previous year's estimates and the actual expenditures of the year before that.

6.49 This General Summary table is not a summary of appropriations because it does not include the full wording of the votes. The information in the summary table is repeated, with the full vote wording as the opening presentation of individual programs. It would make more sense to include the full vote wording in the summary table to facilitate the preparation of appropriation bills or alternatively condense the summary table further to highlight the major programs and leave the full wording to the individual program presentations.

6.50 In addition to the General Summary table, there should be disclosure of the aims? organization, and responsibilities of the various entities reporting to each Minister. This should be supplemented by narrative highlights explaining the significant goals and underlying factors influencing year-to-year changes in the amounts requested. An illustration of such a presentation is provided for the Department of Agriculture on Exhibit 6.3 and for the Department of National Health and Welfare on Exhibit 6.4.

Exhibits not available

6.51 Appropriation structure. The structure of appropriations has a significant impact on the expenditure information now provided to Parliament in the Estimates. Traditionally, and legally, parliamentary control over governmental expenditures has been determined by the vote structure and vote wordings more than by any other single factor. Since the Government may not exceed the expenditure limit for each individual vote, it follows that the greater the number of votes dividing the total amount to be appropriated, the greater is the control exercised by Parliament. The actual appropriations today, however, are so large that they do not provide Parliament with an effective and reliable basis for control. This is compounded by the extensive

use of Supplementary Estimates to transfer funds among votes and to supplement the amounts originally provided.

6.52 To provide greater managerial flexibility, as a prerequisite for greater accountability, and to show more completely the costs of government programs, the Glassco Commission recommended a decrease in the number of votes and improved disclosure of expenditure information about programs within each vote. The vote reduction recommended by Glassco occurred -- 495 votes for about \$3,600 million in budgetary expenditures in 1961-62 were reduced to the current 233 votes for almost \$20,000 million in budgetary expenditures. There would be even fewer votes if capital expenditures in excess of \$5 million, and grants and contributions in excess of \$5 million were not voted separately.

6.53 Certain characteristics of the vote structure may affect the disclosure and accountability of the Government to Parliament. These include:

- The vote structure differs significantly from department to department in terms of the materiality of the expenditures involved and the level of accountability established. For example, the \$3,000 million operating expenditures of the Department of National Defence and the \$200,000 cost of the World Exhibitions Program of the Department of External Affairs each rank as one vote.
- The practice of separating operating, capital, and grants and contribution expenditures into separate votes, if these items are material, may restrict managerial flexibility to some extent in meeting program objectives.
- In some cases, votes cross organizational lines, and accountability for costs by vote may become a matter of allocation and opinion. In such cases it is difficult to identify and limit expenditures to the amounts specified.

6.54 We are, however, not suggesting any change in the vote structure since we are illustrating other means for improving disclosure and establishing accountability.

6.55 Appropriation wording. A second issue concerns the wording of appropriation authorities. The authorities contained in the annual Appropriations Acts are phrased in the form of brief, permissive, enabling terms such as "program expenditures", or in cases where separate appropriations are required within a program, "operating expenditures", "capital expenditures", and "grants as listed in the Estimates and contributions". Within established dollar limits, it is readily acknowledged by legal experts and senior officials that these vote wordings impose no practical legal restriction on the nature of costs which can be incurred or activities which can be undertaken under the authority of the Appropriation Acts. Additions to the standard appropriation wordings tend to increase, rather than restrict, the authorities by providing specific legislative authority for a new activity, by authorizing commitments and expenditures for future years, or by permitting the spending of revenues. The Appropriation Acts are not formally tied to the supporting information in the Estimates, the narrative statements of program objectives and descriptions, or to the schedules of objects of expenditure, manpower and major capital projects.

6.56 Although appropriations could be made more numerous or appropriation wordings lengthened in an attempt to make them more specific, such measures might cause managers to restrict their accountability to narrow compliance with the letter of the law. What is

needed is to make the entire Estimates document an integral part of the accountability process. Many managers state that the information contained in the Estimates, other than that incorporated in Appropriation Acts, is not legally binding on them. This is true in a legal sense. Nevertheless, the Government should encourage managers to recognize an obligation to account for differences between what they said they would do and what they actually do. If the Government created this expectation, parliamentary accountability would automatically follow.

6.57 The preceding comments serve to highlight the need for more detailed disclosure if Parliament is to comprehend fully the Government's expenditure intentions. The wording of Appropriation Acts alone cannot satisfy this need.

6.58 Disclosure of statutory authorities. Continuing statutes now authorize almost 60 per cent of the annual expenditures listed in the Estimates. These statutory programs, some of the largest and most volatile components of government spending, provide continuing unlimited authority for paying certain types of grants and contributions to other levels of government and to organizations or individuals in the private sector. Almost all the major statutory appropriations appear in the Estimates as one-line references to the statute, with a projected expenditure total and no further supporting information or explanation. In some cases an explanation of the level of spending can only be obtained by referring to these separate statutes and the supporting regulations, agreements and Orders in Council which are often difficult to understand. As a result, expenditure forecasts are difficult to assess. Other than through the Estimates review process, parliamentarians have no systematic basis for reviewing these statutes or the changing content or costs of the programs covered. Clearly, if they are to review Government expenditure plans effectively, the Estimates should include improved information on statutory appropriations, particularly the assumptions on which the forecasts are prepared. The illustration of the Estimates of the Department of National Health and Welfare shows the type of disclosure required.

6.59 The Estimates of Crown corporations. The 1976 and 1977 Reports of this Office discussed in some detail the question of financial management of Crown corporations and presented a number of recommendations that "... were designed to enable Parliament and the Government to control effectively the activities of those Crown corporations that are subsidized in whole or in part from the public purse...." Included in these recommendations were several which called for improved disclosure in the Estimates of the plans and financial requirements of Crown corporations as well as better comparative reporting of performance in the Public Accounts.

6.60 At present, the Estimates provide a minimal amount of information about Crown corporations. In many cases general narrative descriptions accompany one-line items showing only the net excess of expenditures over revenues that must be met by parliamentary appropriation. During our study of the form of the Estimates, we examined the information disclosed in the Blue Book for several Crown corporations. It is of some significance that an attitude was encountered which suggested that present disclosure was adequate and indeed that should a Crown corporation be able to operate at a profit and therefore not require appropriations, no information at all need be presented to Parliament in the Estimates.

6.61 The Report on the Study of the Accounts of Canada discussed a number of questions relating to accounting for Government enterprises. The report noted:

"Any examination of the accounts of Crown corporations must proceed from the premise that the accounts of Crown corporations are intended primarily to ensure accountability to Parliament and to serve as an effective means of communication to Parliament, the government and the people of Canada. To accomplish this intent, the accounts should produce, to the extent feasible, the information which all interested parties require to comprehend and make decisions on government activities."

6.62 Throughout this Chapter, attention has been drawn to the connection that should exist between the Estimates and the Public Accounts and to the fact that improved disclosure in the former should result in better disclosure in the latter.

6.63 With these objectives in mind, the Estimates demonstration project included the preparation of model estimates that might be considered for several Crown corporations. Such estimates presentations for the Canadian Dairy Commission and the Farm Credit Corporation are included. We have also prepared a possible presentation for the St. Lawrence Seaway Authority.

6.64 Cash or cost data? The tables in the Estimates present estimated cash disbursements less any revenues credited to the vote to arrive at the net cash costs for the program as a whole. This presentation of anticipated cash flows tends to focus on cash, not on the full costs of the activity or program. "Total program costs" are arrived at by subtracting from the net cash costs:

- revenues generated by the program that are credited to the Consolidated Revenue Fund; and
- services provided free to other departments;

and adding:

- services provided without charge by other departments or by the department itself.

6.65 Although the Blue Book contains the calculations required to convert cash requirements into total costs, the way it is done and the relative emphasis on cash costs tend to obscure the significance of the total. Moreover, the total cost of each individual activity is lost since the calculation covers only the whole program.

6.66 Exhibit 6.5 illustrates an alternative approach for the Department of Agriculture. Although introductory information for each program maintains the necessary distinction between voted, statutory and notional (non-cash) costs for appropriation purposes, activity figures are shown on a total cost basis.

Exhibit not available

Presentation of Program Information

6.67 Central to the financial management policies adopted in the 1960s was the concept that planning, budgeting and expenditure control should be based on major, self-

contained programs among which the Government might allocate resources in the light of its priorities. The operations of departments would be subdivided into a few major components to be called programs and they would provide the basis for appropriations. It was recognized that they would have to be subdivided into smaller components that would be understandable and useful for resource allocation and management control. Three such subdivisions were identified by the Treasury Board:

- by activity to show the costs of the activities undertaken in pursuit of the objectives of the program;
- by organization to identify who is responsible; and
- by object of expenditure to provide a means of determining resource requirements, and of analyzing and controlling the acquisition and utilization of resources.

6.68 By activity. Since 1971, the Estimates document presented to Parliament has attempted to provide program and activity information in addition to object-of-expenditure data. The presentation of departmental programs subdivided by the activities to be undertaken in pursuit of program objectives was intended to compensate for the detail lost in the consolidation of votes.

6.69 The Treasury Board in its Planning, Programming Budgeting Guide explained how programs were to be subdivided by activities. It defined activities in the following terms:

The activity structure within a program must be designed to assist resource allocation decisions.

The activities of a department are the headings under which the department will negotiate for funds with the Treasury Board, the headings under which requirements can be best explained and the benefits forecast.

The activities of a department provide the focus for planning by the department in deciding how to achieve program objectives.

Each activity should involve the largest set of projects possible as long as the objectives to be served do not become too diverse.

In delineating the activity, it is important to remember that for it to be meaningful, the mix of operations should be homogeneous in character.

6.70 The activity structure departments use internally measures up to these criteria reasonably well. In presenting this information in the Estimates, however, activities have been grouped to a point where the information does not provide adequate support for the proposed funding.

6.71 Activities should be built up in a hierarchical fashion, starting with the lowest levels at which an output can be identified. Depending on their nature, activities may be continuing processes or one-time projects. For example, activities for the Research Program of Agriculture are built up from a large number of individual projects at research stations and farms

across Canada. In the Health of Animals Program, however, the activities of meat inspection, animal pathology and the testing of animals for contagious diseases are built up from the costs of a number of on-going processes. These detailed activities are not now presented in the Estimates.

6.72 It should be recognized that there are instances when it will not be simple to identify useful activities because, to meet the Board's criteria, they must be:

- based on actual processes or projects being undertaken;
- such that payroll, material and other direct costs can be attributed to them with sufficient accuracy both for estimating and financial reporting purposes; and
- capable of being grouped in an objective and verifiable manner to produce totals for departmental management, Treasury Board and Parliament.

Costs that do not permit this treatment should be included in separate overhead or supporting activities.

6.73 The present degree of grouping may have been designed to avoid giving Parliament excessive detail, however, as suggested previously, meaningful activities should go down to the point where results can be related to costs. This usually discloses detail at such a low level that it would be impractical to present it in the Estimates. It is possible, however, to show how the information presented is built up from the individual processes and projects. Exhibit 6.6 illustrates such a presentation for the Research Program of the Department of Agriculture.

Exhibit not available

6.74 For some programs information relating benefits to costs is meaningful only at the program level. For these programs, identification of costs by activity is probably not worthwhile since there are no activity outputs to permit assessment of efficiency. Such programs should be analyzed in terms of objects of expenditure and justified by comparing the total cost to the benefits derived.

6.75 In summary, the activity information submitted to Parliament can be improved by:

- disclosing activities at a lower level of grouping where outputs can be related to costs;
- including in activity costs only those cost components that directly pertain to the activity and can be allocated to the activity on an objective and verifiable basis;
- including unallocated costs in separate supporting or overhead type activities; and
- providing, wherever possible, the output data to which costs can be related.

Exhibit 6.7 provides an example of a schedule showing detail by sub-activities and Exhibit 6.3 shows how performance data might be presented for an activity in the Health of Animals Program of the Department of Agriculture.

Exhibit not available

6.76 The departmental illustrations show the types of activity detail that departments now use to justify their Estimates. A later section of this Chapter will refer to the concerns this Office has about the quality of some of this financial data. If departments believe that this information properly explains the nature of their requirements, these deficiencies should be remedied. The activity structure considered to disclose a department's activities best should be abandoned if it cannot be supported by reliable data.

6.77 By responsibility. The Estimates do not explain the funding required in terms of the organizational units involved, but most departments build up their Estimates by identifying the costs of each responsibility centre, with unallocated costs being estimated centrally.

6.78 The decision not to include responsibility centre information is surprising since organizational costs were disclosed from 1938 to 1971 by virtue of the fact that votes corresponded by and large to the branches and divisions of a department. The omission of responsibility information was apparently based on the concern that providing it would undermine the concept of ministerial responsibility for the entire program.

6.79 When Treasury Board policies were being developed in the post-Glassco period, it was expected that expenditure control systems would rest on the responsibility structure since this was the way the departments were holding their managers accountable. It was also intended that the Treasury Board would establish allotment controls at some suitable level in this responsibility pyramid. With few exceptions, this has not happened since allotment controls continue to be exercised largely on the basis of groups of objects of expenditure within votes.

6.80 In all departments that were examined, financial data by responsibility centre are readily available. Exhibit 6.8 illustrating the Law Enforcement Program of the RCMP, shows how program costs for Headquarters and each of the field divisions are broken down for purposes of expenditure control. Exhibit 6.9 shows an alternative way of presenting responsibility data for the Energy Program of the Department of Energy, Mines and Resources.

Exhibit not available

6.81 Relationship between activities and responsibilities. The need for making a distinction between the subdivision of programs by activity and by responsibility centres stems directly from the fact that the two will not always be identical and, where they are not, departmental systems of expenditure planning and control will frequently be based on the latter. For example, in any program carried out on a geographically dispersed basis, it will be usual for decentralized organizational units to prepare budgets and to exercise financial controls.

6.82 Although the estimates for the Law Enforcement Program of the RCMP are determined first by establishing priorities for each activity, they are then broken down by individual Divisions across Canada where most of the actual police work will be undertaken. It is quite common for most Divisions to undertake many, if not all, of the police activities making up the Program. The Force exercises financial control over the Program by holding each divisional Commanding Officer accountable for keeping costs within his approved budget. In addition, the RCMP allocates costs to the various activities so providing the capability of comparing actual costs with the funding priorities originally established. It will be apparent from the foregoing discussion that the presentation of programs solely by activity may obscure the manner in which

the approved funds are to be managed. The additional presentation of programs by responsibility would focus attention on this important aspect of financial management.

6.83 When programs and activities were introduced in the 1960s, activities were defined as being the first breakdown of a program. No provision was made for sub-programs. As a result, many of the activities now presented fail to satisfy Treasury Board criteria for an activity. Departments have found it convenient, if not essential, to introduce a sub-program level into their planning before getting down to the level of detail that is represented by actual activities, i.e., the operations, processes and projects that truly represent the means for attaining a program's objectives.

6.84 Normally, programs can be subdivided into sub-programs which either identify one of the objectives of the program or an area of interest or a group of beneficiaries. This sub-program level is where benefits can be identified and the effectiveness of the program or a portion of the program can be judged. For example, if the objective of a program is to market agricultural goods, sub-programs might be defined in terms of markets, agricultural products or types of farmers. Sub-programs normally will involve a number of responsibility centres. Within these centres, activities are being performed and it is at this level that their efficiency can be assessed. Thus, there can be a hierarchical structure of programs, sub-programs, responsibility centres and activities. Alternatively, programs and activities can be assigned to a number of responsibility centres and responsibility centres can be involved in all or some of them. Exhibit 6.9 illustrates the relationships between activities and responsibility centres.

Exhibit not available

6.85 The relationship between sub-programs, activities and responsibility centres will differ with each program. A standard presentation cannot properly reflect these differences.

6.86 By objects of expenditure. Before the changes, that began to be introduced in the mid 1960s, the Estimates presented in a "Details of Services" section a breakdown of each Vote by 22 standard objects of expenditure and 10 special categories of transfer payments (e.g., Interest on the Public Debt, Family Allowance Payments). Some of these objects were further sub-divided to disclose significant components. For example, "Major Procurement of Equipment" in the capital vote of the RCAF was subdivided into aircraft, transport equipment, armament, etc. Since the Treasury Board generally established allotment controls on the basis of these objects, their presentation in the Estimates told how the Board would exercise central control within the votes authorized by Parliament. A few departments provided further information about planned spending on a provincial basis or by individual organizational units, such as national parks or diplomatic missions. The standard object details otherwise represented the only information provided to support departmental votes.

6.87 Following the recommendations of the Glassco Commission and the subsequent Treasury Board studies, the nature of the supporting data changed. As part of the introduction of Planning, Programming Budgeting (PPB) systems, the focus of attention shifted to activities, away from the resources to be consumed (standard objects). By 1969, in the interests of accounting simplification, the standard objects were revised substantially. The former 22 objects were reduced to 12 and the 10 special categories were combined into one. The 1970-71 Estimates retained a table for each program, showing objects by the 12 standard objects without any special objects to disclose further detail.

6.88 As a result, since 1962, object-of-expenditure data have been significantly condensed. For example, in the 1962 Estimates, the operating and capital votes for each of the three branches of the armed forces were explained in terms of some 129 separate objects. Following unification of the three services, the consolidation of the former six votes into one and the introduction of the new standard objects, these were condensed into 19 items.

6.89 In considering the question of how much object-of-expenditure information should be presented, Parliament has two broad alternatives:

(a) less information, by further contracting the objects, as in the recent proposal by Treasury Board, to use seven standard objects as follows:

1. Personal Services and Benefits
2. Other Purchased and Contractual Services
3. Purchased Goods and Materials
4. Transfer Payments
5. Financial Claims (against the Government)
6. Other Expenditures; and
7. Transactions Internal to the Government; or

(b) more information, through a subdivision of the present or proposed objects to show further details of particular interest to Parliament.

6.90 We believe that the reduced number of objects would be satisfactory for standard use, but where greater detail would be appropriate because of the nature or amount of a proposed expenditure, a given object should be further subdivided. Exhibit 6.10 illustrates, using a hypothetical example, how an expanded object presentation might look using the new standard objects proposed by Treasury Board.

Exhibit not available

6.91 Although it is not apparent from their portrayal in the Estimates, governmental accounting systems provide for extensive subdivision of the standard objects of expenditure into departmental objects to provide data of particular interest to departmental management. These departmental objects, in turn, must be capable of being classified by the extensive, detailed set of standard economic objects used for purposes of economic analysis. A breakdown of standard objects into departmental objects, for example, might show purchased services subdivided into travel, telephones, accounting services, etc.. Thus, further details are available from the accounting system, although these will vary depending on the departmental objects used.

6.92 Government-wide summary information should present object data in total, without showing the amounts for each department and agency. This data, however, should be expanded to show information that better communicates the economic significance of the proposed expenditures.

6.93 Within the departmental sections of the Estimates, objects could be presented either by department or by program. A presentation by responsibility centre or activity would add a very large amount of data that might only be useful in limited circumstances. It may suffice for Parliament to know that more detailed information is available on request.

6.94 Manpower presentations. The amount of information the Estimates present on the government's manpower requirements has been greatly condensed since the early 1960s. In the pre-Glassco period, the details for each vote listed each authorized permanent position by grade within the position classification system and the authorized salary range for each grade. Thus, the Estimates for 1961-62 presented the requirements of the Canadian Army for civilian staff in some 350 lines covering six and a half pages. There can be little doubt that the sheer mass of this presentation tended to obscure rather than inform and it seemed illogical to disclose, for example, that the Army required three railroad trainmen, four plasterers, and one presser and spotter.

6.95 With the introduction of collective bargaining in 1967, the government undertook a major restructuring of the personnel classification system. Six broad categories were devised, and groups were established within each category for appropriate professional and trade occupations.

6.96 The 1970-71 revisions in the form of the Estimates included several changes in presenting manpower data. Summary tables were presented for the first time, two on manpower. Within the departmental sections, manpower data were presented for each program for each of the six categories, showing authorized man-years and planned strength at the end of the Estimates year, the current year and the preceding year. This three-year comparison was amplified for the current and preceding year by showing actual strength at September 30. The presentation of manpower data in the Estimates for 1978-79 is largely unchanged from that of 1970-71.

6.97 Since manpower costs constitute such a major element of the total cost of most departmental programs, Parliament may wish to consider alternative methods of disclosing manpower data. The amount of information that would be presented depends on the level at which the data are portrayed, i.e., by department, by program, by activity or by responsibility centre.

6.98 Two possibilities are:

(a) Continuing to present manpower requirements for each program as at present, but showing trends more clearly by reporting man-years and numbers of employees separately (Exhibit 6.11).

(b) Providing more information by subdividing each category into the groups relevant for that program and showing average salaries for them (Exhibit 6.12).

It will be apparent that these alternatives are not mutually exclusive and that a number of other presentations are possible.

Exhibit not available

6.99 Capital projects. The presentation of major capital projects in the Estimates is well done in that it clearly sets out the financial implications for the Estimates year and future years for all projects that are expected to cost more than \$250,000. In Chapter 7 of this Report, it is recommended that overhead costs of the Department of Public Works should be included in the appropriations for capital projects. A similar approach should be considered for the capital votes of other departments as well.

6.100 Illustrations of the way in which we suggest capital projects could be presented have largely adhered to present practices except that additional information, such as anticipated completion dates, payback and a breakdown of future year's requirements by year, have been added. Exhibit 6.13 shows such a presentation.

Exhibit not available

6.101 Grants and contributions. In the 1977 Report, we drew attention to the findings of a two-year study of grants and contributions undertaken by the Office. The study revealed several important inadequacies in the management of grants and contributions and we made a number of recommendations concerning their treatment in the Estimates. For convenience, the recommendations that relate to the Estimates are repeated below.

"The grouping of grants by categories of recipients should be restricted to small payments made to groups of individuals or to organizations meeting specific legislative requirements or other eligibility criteria; these criteria should be clearly defined by the Treasury Board in the planned directive on grants and contributions."

"Descriptive wordings in the Estimates should clearly identify all the different contribution programs within each department. A list of recipients of contributions should be available in each department and measures taken to prevent duplicate funding."

"A uniform system of classification should be adopted following a review of grants and contributions in the Estimates and a special effort made to minimize the number of grants."

"Financial assistance of a capital nature should be classified as contributions and administered as such, including the requirements for the submission of financial statements and reports on the use of funds."

6.102 Following the presentation of last year's Report, the Treasury Board initiated a review of their Circular 1971-18 on this subject and authorized a new statement of policy, Treasury Board Circular 1977-50 with which this Office agrees completely. Our concerns will now be focussed largely on the extent to which departments and agencies comply with this revised policy.

6.103 The Public Accounts Committee considered these matters in some detail and in its Third Report to the House of Commons dated June 29, 1978, recommended to Treasury Board that:

"(a) all grants and contributions over a minimum
amount be shown separately in the Public Accounts;

(b) where practical, grants and contributions be coded by category of use and by province, in both the Estimates and the Public Accounts;

(c) lists of recipients of grants and contributions be a matter of public record in each department and measures be taken to prevent duplicate funding; and

(d) financial assistance of a capital nature be classified as contributions (not grants) and administered as such, including the requirements for the submission of financial statements and reports on the use of funds."

6.104 During our Estimates demonstration project, we endeavoured to develop presentations that would be in keeping with these concepts. The illustrative Estimates for the Department of National Health and Welfare, in particular, illustrate how significantly greater and more detailed information about grants and contributions could be disclosed for the information of Parliament.

Improving the Quality and Availability of Estimates Information

6.105 The illustrations of Estimates presentations in this Chapter are based on information the departments now produce. Before introducing changes, the activities of each department should be reviewed in relation to their objectives and a structure of programs and activities should be selected that best tells Parliament the purposes for which the department is seeking funds. At the same time the responsibility centre reports and other data now being produced should be reviewed to assess their relevance. In effect, this involves assessing the management information the department needs, not a task to be approached lightly. At the same time, the practicability of producing objective and reliable data along the lines recommended should be assessed. This type of review is, in the first instance, a departmental responsibility, but the Comptroller General will wish to ensure that the information provided also satisfies the Government's collective needs. The role of this Office is to ensure that the needs of Parliament for informative and reliable data are met.

6.106 Although no audit was carried out of the information that departments now compile in support of their Estimates, a number of findings give this Office cause for concern. For example, the Treasury Board approved the activity structure introduced by the Department of Energy, Mines and Resources in the 1978-79 Estimates despite the fact that no accounting system has been developed to capture costs by these headings. It is difficult to see how the 1978-79 Public Accounts can present any reliable information on the actual costs of the new activities under these circumstances.

6.107 The methods used to determine forecasts of expenditure by activity for certain departments' Estimates appear to be reasonable but they cannot be supported by actual costs reported in the Public Accounts. If departments merely allocate actual costs to activities in the same manner as that used in preparing the Estimates, there is no means of knowing whether the information used represents a realistic apportionment.

6.108 Although most departments keep reliable data on responsibility centre and object-of-expenditure costs, their estimates are not necessarily based on such data. Some departments forecast the object-of-expenditure information presented in the Estimates by building it up from object data prepared by responsibility centres, but others either use the formula provided by Treasury Board to project object costs or else estimate them on an

aggregate basis only. Responsibility budgets, although not disclosed in the Estimates, are prepared by most departments, but the total of these responsibility budgets may not agree with the total funding ultimately provided after negotiation internally and with the Treasury Board. Improved data could be provided in the Estimates by paying greater attention to actual expenditures.

6.109 Our Office believes that the information in the Estimates and Public Accounts should be comparable and that it should be possible, by auditing both estimated and actual expenditures, to tell parliament whether funds have been spent for the purposes for which they were appropriated. An effective expenditure control system can only operate by comparing actual expenditures to plan and by identifying Variances, thereby highlighting the possible need for action.

6.110 For these purposes, estimating and accounting should be consistent, objective and verifiable. This is why my 1975 Report recommended that a single central agency should be responsible for the form of the Estimates and Public Accounts. This is Important since those in the Program Branch of the Treasury Board Secretariat, who prepare and review the data presented in the Estimates, have little contact with those who prepare and verify the data presented in the Public Accounts.

6.111 These responsibilities for the integrity of financial data have now been given to the Comptroller General. For the Comptroller General to establish an effective system of expenditure control, he must ensure that the information the Government uses to allocate resources is reliable and that actual data are reported consistently. This imposes on the Comptroller General a responsibility to satisfy himself that the data in the Estimates and Public Accounts are accurately and objectively compiled and are comparable. The Government needs this for its own purposes; a by-product should be reliable data for Parliament's purposes.

6.112 This Office believes that one of the Comptroller General's first priorities should be to ensure that accurate and reliable information is available for decision-making purposes at all levels. By starting initially with the Public Accounts and ensuring that data on the costs of government services, resources used and responsibility are shown, the nature of the data potentially available for purposes of improving the Estimates would be established. This would permit decisions on how much data to show in the Estimates, with the assurance that anything not provided is available if needed. This approach would be particularly beneficial if management information systems showing non-financial data were also examined to determine their reliability for purposes of providing performance data, first in the Public Accounts and then in the Estimates.

1978 Report of the Auditor General of Canada - Chapter 7

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Charging for Accommodation Services</H1>
</CENTER>

<HR>

Introduction

7.1 Purpose. For almost two decades the debate about charging departments for common services has waxed and waned. The position of the Government has been mixed. A policy decision was made in 1966 to charge all departments and agencies for procurement services and subsequently the Supply Administration of the Department of Supply and Services (DSS) was placed on a full cost-recovery basis. The other major common service - the provision of accommodation by the Department of Public Works - has not been dealt with in a similar manner.

7.2 The arguments of both proponents and opponents of charging for accommodation services are summarized below. Whatever the merits of these arguments, it is clear that the present practice of funding the Department of Public Works for accommodation, which other departments occupy free of charge, satisfies neither the providing nor the using departments. Moreover Parliament is ignorant of the full cost of departmental programs since nowhere do the Estimates report accommodation costs by program.

7.3 There has been no action on recommendations of the Public Accounts Committee that departments be charged for accommodation services. Since the Department of Public Works' Main Estimates this year amount to some \$710 million for accommodation, a significant sum, we decided to review in some detail the considerations that would affect a decision to charge for accommodation and the features that should be incorporated in any system for doing so. This also provides an opportunity to suggest the kinds of information on common services that Parliament might find useful in the Estimates and Public Accounts to make the providers and the users of the services properly accountable.

7.4 In 1976 the Government submitted to the Standing Committee on Public Accounts, as part of the Study of the Accounts of Canada, a proposal to change the manner of accounting for revolving funds. Although this proposal received the Committee's support, action has yet to be taken to implement it. Accordingly, since the financial procedures we are suggesting contemplate the greater use of revolving funds, they will vary depending on whether or not advances to revolving funds are treated as budgetary expenditures. The effect of this is explained, where appropriate.

7.5 Key issue. As in the Estimates discussion in Chapter 6, the essential issue is the need for improved accountability by those who provide and those who use accommodation services. To achieve this, there must be more complete disclosure to Parliament of:

- the cost of buildings constructed, bought or leased to provide accommodation;
- the cost of space occupied in carrying out government programs; and

- the efficiency and effectiveness of Public Works as the central agency responsible for acquiring and providing accommodation services.

7.6 The problem with present arrangements is that financial information submitted to Parliament obscures the relative responsibilities of program managers, Public Works and the Treasury Board. Adequate accountability requires the Government to adopt the practice of charging departments for accommodation. This could also provide the spur and the incentive needed to achieve better accommodation management by users and providers. If improved accountability and management are to result, the degree of disclosure of accommodation costs in the Estimates and Public Accounts is of major importance. Consequently we give primary attention to the methodology that should be followed under any system of charging for accommodation.

7.7 The history of the debate. The starting point of the debate was probably the 1960 Report of this Office which pointed out that the practice of including all accommodation costs in the Public Works Estimates resulted in understating expenditures of other departments. The Public Accounts Committee in 1961 recommended that the costs of major common services be distributed to departments for information purposes and the Estimates for the 1962-63 fiscal year showed for each department the cost of a number of common services, including the accommodation provided by Public Works. The amounts shown were approximate only and were presented on a notional basis.

7.8 The Glassco Commission shortly thereafter went further and recommended that departments and agencies be charged for accommodation because "only thus will departments be aware of the monetary consequences of their space requirements."

7.9 On several occasions later in the 1960s the Public Accounts Committee, the Standing Senate Committee on National Finance, and this Office advanced arguments for improved disclosure of the costs of departmental accommodation. In 1970 the Public Accounts Committee recommended that departmental appropriations be charged for these costs. This recommendation was accepted by the Department of Public Works, but it was opposed in 1975 by representatives from the Privy Council Office and the Treasury Board Secretariat serving on a committee that examined the question. The Public Works representative on the committee dissented from their view.

7.10 In our 1976 Report, we commented on the inadequacy of the accounting for accommodation. Although we expressed concern about the cost of establishing a system to charge for accommodation services, we suggested that the Treasury Board should again consider such a step as soon as it was able to assess the effectiveness of alternative controls, then newly introduced. This recommendation was repeated in our 1977 Report, but as far as we know, no action has yet been taken.

To Charge or Not to Charge?

7.11 All of the policy matters involved in a decision to charge user departments for accommodation services have been fully developed over the years. A brief summary of the arguments on each side should assist in gaining a better understanding of the issue.

7.12 Arguments for charging. Those who favour charging users for accommodation provided by Public Works believe that:

- costs of government programs are understated unless accommodation is charged to them;
- better resource allocation decisions will result if user departments have to balance improvements in accommodation against other competing claims for their scarce program funds;
- both users and the provider (Public Works) will become more conscious of accommodation costs, a concern that at the moment tends to be limited to Public Works;
- planning for accommodation will be improved if program managers with first-hand knowledge of their accommodation requirements have to determine their needs independently;
- Public Works will be required to exercise more effective control over costs if its sources of revenue are limited to rates comparable to those that would have been paid to the private sector; and
- the incentive for adequate cost systems will be created within Public Works if it has to control its costs and live within its revenues.

7.13 Arguments against charging. Those who oppose the funding of user programs and who favour continuing the present system of appropriating funds to Public Works believe that:

- Public Works will continue to have a monopoly on providing space and therefore funding of user programs will do little to improve its efficiency and effectiveness;
- senior departmental management will not assume responsibility but will delegate it to their own supporting staffs, since accommodation costs are small relative to other expenditures;
- the ability of Public Works to challenge user departments will be weakened resulting in uncontrolled escalation in the use of space and an accompanying increase in accommodation costs;
- governments will continue to base acquisition decisions on political or economic requirements rather than on the particular needs of users;
- accommodation planning on a fragmented basis will not be as effective as central planning by trained personnel; and
- the introduction of systems for billing user departments will cost more than the benefits warrant.

7.14 Assessing the arguments. We believe that a decision to charge user departments for accommodation services would help overcome present weaknesses by disclosing more fully:

- the impact of accommodation costs on programs;

- the efficiency of Public Works through the relationship between the Department's full costs and revenues based on fair market values; and
- the effectiveness of Public Works as a central agency in providing accommodation services by comparing its performance with that of the private sector.

7.15 The arguments against such a decision are not convincing. Program managers should be held accountable for the quantity and quality of the accommodation they occupy, even though they cannot be held accountable for its cost in view of the monopoly position of Public Works. In the private sector, branch managers are faced with comparable situations as a result of similar corporate decisions. Moreover, the fact that accommodation costs are less significant than other costs is hardly a reason for indifference on the part of program managers.

7.16 Public Works is already in a purely service role. Neither dilution of control nor escalation of accommodation costs should result, as alleged, because the Treasury Board, not Public Works, is now responsible for expenditure control through allocation of budgetary resources and establishment and application of government-wide standards for use of space.

7.17 Governments may wish to have construction of public buildings begun or deferred for policy or economic reasons, but such decisions do not mean that they wish to ignore all other considerations and build then without regard for their cost and future use. More effective planning is likely to result by allocating scarce resources on a total program basis than by considering accommodation costs separately. Improvements in the flow of information from other departments, and the need for them to commit themselves at an earlier stage, would also enable Public Works to plan and allocate its resources more effectively.

7.18 Finally, the added cost of completing the system should not be excessive since the Department has already expended a good deal of effort on it, and has set up a "shadow billing" system to identify the amounts that would be charged. A system already exists for charging departments for certain tenant services.

The Probed Method of Charging for Accommodation

7.19 Our proposals assume that the Department of Public Works will continue to be primarily responsible for acquiring and managing the accommodation services government departments need. The proposed methods of financing these services recognize that, in carrying out this mandate, Public Works performs three functions:

- maintaining and using properly the accommodation that is available;
- acquiring any additional accommodation that departments require through construction, purchase or lease; and
- providing the expert professional and technical services it needs in carrying out these functions, as well as those services needed by departments and agencies having specialized buildings under their own management.

7.20 The effectiveness of Public Works in providing these common services, and of departments in using them, will be made more visible by:

- establishing a Building Operations Revolving Fund to finance the operating costs of accommodation occupied by user departments;
- establishing a second revolving fund, the Accommodation Management and Professional Services Revolving Fund, to finance the professional, technical and other services Public Works provides in acquiring and managing accommodation; and
- continuing to finance new accommodation, whether acquired through construction, purchase or lease, through annual parliamentary appropriations.

7.21 This proposal may appear to be unduly complicated, but the different things for which government managers are accountable must be recognized in the Estimates and Public Accounts if any effective accountability is to result. Parliament must know whether:

- accommodation is being effectively used, by requiring the various programs to include the costs of accommodation in the expenditures they must justify;
- the stock of available accommodation is being efficiently managed;
- the quality and cost of professional, technical, and other services provided centrally compare favourably with results when departments provide their own or buy the same services from the private sector;
- construction, purchase or lease best satisfies the need for additional accommodation; and
- existing and planned accommodation meets user needs.

7.22 The following discussion recognizes that, in providing accommodation services, the Government may seek to satisfy some policy objectives in addition to those reflected in the programs of user departments. For example, new accommodation may be acquired primarily to create employment or correct regional disparities. The proposals we are suggesting are designed to focus more attention on the financial implications of the various choices the Government has to make in deciding to add to its capacity to provide accommodation, how best to manage the stock of accommodation that it already has, and how to most efficiently provide the various services necessary in acquiring or managing accommodation. With this information available, the cost of attaining other policy objectives can be better assessed.

7.23 The following three sections explain how the Building Operations Revolving Fund would function, how normal parliamentary appropriations could continue to be used to finance the acquisition of accommodation and how the Accommodation Management and Professional Services Revolving Fund would disclose more fully the costs of the professional and other services Public Works provides.

7.24 The illustrative Estimates of the Department of Public Works, developed by the Office, are designed to incorporate the principles proposed. The Marine Program and the Transportation and Other Engineering Program were not illustrated since they are not involved in the accommodation issue.

Managing Existing Accommodation - The Building Operations Revolving Fund

7.25 The Building Operations Revolving Fund would facilitate the development of a realty management system by Public Works on a basis that permits comparison with the private sector. For this to exist:

- the Fund must be charged all costs that would be borne by a landlord renting similar space to the government, including some appropriate method of recognizing the capital cost of accommodation used; and
- the Fund must be credited with the same rents user departments would pay for the same accommodation in the private sector.

Exhibits 7.1 and 7.2 taken from the illustrative Estimates show how the operations and financial condition of the Fund might be shown.

Exhibits not available

7.26 Costs charged to the Fund. Market rates in the private sector are intended to permit the owner of a building to recover:

- direct operating costs, including alterations, cleaning and public utilities;
- municipal taxes;
- interest;
- mortgage principal (or depreciation);
- management, administrative and overhead expenses (often a management fee, usually calculated as a percentage of gross rents, is included in the rental rate to cover most of these costs);
- insurance;
- income taxes; and
- profit after taxes

7.27 Except for income taxes and profit, the Fund should be charged with all of these amounts, as well as with payments for rental of buildings leased from the private sector.

7.28 In the case of Public Works, it is suggested that a management fee be charged to the Building Operations Revolving Fund, instead of actual costs. If the management fee is based on that charged by the private sector for comparable services, and this fee is credited to the Accommodation Management and Professional Services Revolving Fund, there will be a yardstick for assessing Public Works' performance based on the relationship between that Fund's revenues and actual costs.

7.29 The amount to be charged annually to account for the capital cost of buildings poses special problems. In the private sector, the landlord is primarily concerned with recovering sufficient revenue to cover cash flow - namely all expenses plus payments on mortgage principal - as well as to provide a reasonable return on investment. Although depreciation is also recorded in the accounts to amortize the cost of buildings over their useful lives, this is a secondary concern as long as depreciation is less than payments on mortgage principal.

7.30 Since cash flow, not costs, mainly determine rental rates in the private sector, depreciation could be recorded so it would approximate principal repayments under normal financing arrangements in the private sector if this would produce data more comparable to the private sector.

7.31 It is apparent that the Building Operations Revolving Fund could not be expected to absorb the costs of space that becomes unoccupied as a result of a policy decision by the government to relocate departmental operations for reasons unconnected with the conduct of the programs concerned. The positions of Public Works, as landlord, and of user departments, as tenants, should be formalized through lease agreements specifying the responsibilities and obligations of each party. These leases should be for appropriate commercial terms and provide for rent increases in a normal commercial manner. If a department is relocated as a result of a government policy decision, that department should be responsible for ensuring that it receives sufficient funds to honour its lease commitments until some suitable alternative use for the vacated accommodation is found.

7.32 Setting rental rates. User departments will be vitally concerned with the methods used to determine rental rates. The forces of the market place determine rates in the private sector. These forces include the current and prospective demand for space of a particular quantity and quality, the existing and planned supply of such space and the need for suppliers to receive a reasonable return on their investment if they are to add to or maintain existing space. If there is to be a valid yardstick to which Public Works can be compared, it should be subject to the same forces to the maximum extent possible. Both Public Works and users would see the system as equitable if rental rates were objectively determined by comparison with rates for comparable space in the private sector market. The determination of rental rates in this fashion, however, cannot be left either to the supplier or to the user as long as bargaining between the two is constrained by Public Works' monopoly in providing such services. Rates proposed by Public Works, as a result of its objective appraisal of the market, should be discussed with user departments, with the Treasury Board acting as a regulatory agency in reviewing and approving rental rates.

7.33 Setting current, fair market rental rates is not a simple task because of the obvious difficulty of making judgments about what is, in fact, comparable space available in the private sector. The Government owns several categories of buildings for which the determination of rental rates will be more difficult than it is for office space. Some single purpose buildings - for example, post offices that are funded by Public Works - should be financed in the same manner as multiple purpose buildings, with rental rates developed between Public Works and the Post Office, and approved by the Treasury Board. Some single purpose buildings, however, are of such a unique character - the Parliament buildings being the most notable example - that comparisons with the private sector are impossible. For such buildings, capital costs should be treated as sunk costs, with rental rates set to recapture current operating costs only.

7.34 There will be occasions where services are not comparable. For example, Public Works may lease a building for which the landlord will provide certain of the services Public Works normally provides. In these cases, the rent Public Works charges user departments should consist only of amounts paid to the landlord, together with an appropriately reduced management fee. Alternatively, if user departments demand services or facilities not found in comparable commercial accommodation, rent should reflect the added cost.

7.35 Treatment of excess revenues or expenditures. If based on comparable rents in the private sector, rents departments pay for space they occupy should generate enough revenue to cover all costs. Depreciation, taxes, interest and insurance, however, are not costs that Public Works is now required to pay. These costs should be identified separately, be paid by the users, and credited by Public Works to the Consolidated Revenue Fund. In this way, any residual amount will be equivalent to profits before taxes in the private sector.

7.36 Under present practices in accounting for revolving funds, if the Accounts of Canada are not to be unduly altered, year-end profits should be recorded as revenue to the Consolidated Revenue Fund and any loss should be recorded as an expenditure after receiving authority by means of parliamentary appropriations. Once the recommendations of the Study of the Accounts of Canada are implemented and amounts advanced to revolving funds are treated as budgetary expenditures, this will not be necessary. Thereafter, the Accounts of Canada will recognize any excess revenue or expenditure of revolving funds, instead of carrying excess expenditure as an asset and excess revenue as a liability as under present rules for revolving fund accounting.

7.37 Once the proposals of the Study of the Accounts of Canada are put into effect, profits, in excess of a reasonable commercial return, and losses could be carried forward from year to year so that the Fund would show the cumulative results of Public Works' operations and, at the same time, cause it to bear the interest cost of any net deficiency or to benefit from reduced interest if revenue exceeds expenditure. This would place Public Works in a situation that is more comparable to the private sector.

7.38 Accounting for capital assets of the Fund. Once the Building Operations Revolving Fund has been established, new buildings would be taken into the Fund as assets when complete and ready for occupancy. The offsetting credit should be made to a contributed capital account, not to a liability account, since in the Accounts of Canada such assets are written off and carried at the nominal value of one dollar. The capital cost of the buildings available for rent should be carried in the accounts of the Revolving Fund in this contra fashion and depreciated in the same manner so that the accounts will show whether the rental payments will eventually recover the original capital costs.

7.39 Buildings completed when the Fund was established present a special problem. Since the income to the Fund from rentals would be based on fair market rates rather than original capital costs, it follows that the Fund should not be placed in the position of receiving income from buildings that were paid for in previous years without an offsetting obligation to recover through depreciation the current fair market value of each building. Existing buildings should, therefore, be taken into the Fund at their current economic value based on their likely future life and the rents that will currently be charged for them. This would avoid any need to determine their current replacement cost.

Acquiring New Accommodation - Appropriations for Construction, Purchase or Lease-purchase

7.40 Parliament now grants separate capital appropriations to finance the construction or purchase of new accommodation wherever the total value in any program exceeds \$5 million. All projects that exceed \$250,000 are listed separately in supporting tables. The amounts included in the figures shown for these projects are only what departments expect to pay for land, design and construction contracts with firms in the private sector and for employees involved full-time in direct construction activities.

7.41 Accommodation acquired through lease agreements is financed from operating votes, but again the amounts shown as rentals in the Estimates include only the payments to be made to the lessor under the terms of the agreement and, in some cases, initial fit-up charges not included in the lease agreement.

7.42 If valid comparisons are to be made among the relative merits of construction, purchase or lease methods of acquiring space, total costs must be included for each, especially since lessors will certainly set lease rates to recover the full costs of the buildings they lease to the Government. To achieve this, all costs should be charged to the capital appropriation and lease-purchase arrangements should be presented in the Estimates and be accounted for as if they were, in fact, purchases. These two issues are considered below.

7.43 Construction or purchase of accommodation. Present practice in accounting for capital projects clearly understates costs. Full disclosure of the total cost of a project would require the inclusion (in addition to costs now shown) of the following:

- direct project support and administrative costs, now financed out of other Public Works appropriations or out of the operating votes of other departments;
- costs of grants in lieu of taxes and interest on borrowed funds during construction, now financed by other appropriations; and
- costs of insurance, not paid because the government does not insure itself against hazards normally covered by insurance in the private sector.

7.44 Determining the amounts not now included should present little difficulty, but the methods followed for support and administrative costs are significant to the entire concept being suggested here.

7.45 The alternative approaches for determining amounts to be included in capital votes for direct project support and administration, now borne by operating votes, are:

- estimating actual departmental costs for design, construction, supervision and administration for each project in the Estimates and showing actual costs in the Public Accounts; or
- estimating and recording the amount of the costs that ought to be incurred by applying the relevant fee schedule established by the provincial associations of professional architects and engineers.

The second alternative is preferable, not only because it provides the government with a benchmark against which to measure Public Works' performance, but also because it results in a presentation in the Estimates and Public Accounts of costs of construction that will permit valid comparisons with the costs of similar buildings being constructed in the private sector.

7.46 For the cost of government projects to be comparable, they should also include costs that the Department of Public Works will not be required to pay, such as interest, municipal taxes and insurance during construction. Notional amounts, based on government borrowing rates and prevailing commercial insurance premium rates, should therefore be included in accounts for each project.

7.47 If the foregoing suggestions are accepted, the capital vote for Public Works would present to Parliament the following information for each major project:

-	Land	\$
-	Professional Fees	
-	Construction Costs	_____
	Total Cash Required	\$
Add: -	Interest on Capital	
	- Insurance	
	- Grants in Lieu of Taxes	_____
	Total Project Cost	<u><u>\$</u></u>

How this might be presented is shown in Exhibit 7.3.

Exhibit not available

7.48 The question of cost overruns must be considered in the system being suggested here. Overruns can result from unforeseeable circumstances such as unexpected soil conditions. These additional costs, including related design costs, should be paid from funds in project estimates for contingencies and otherwise come from funds that may be available from savings on or cancellation of other acquisition projects. The Department should have to seek Parliament's approval only if additional funding is required for the vote, although it should remain accountable through the Public Accounts for the costs of each project.

7.49 Leasing. Leased buildings are now financed quite differently than those constructed or purchased. The annual rents are charged to operating votes over the term of the leases. The total rentals far exceed the capital cost of the same accommodation, because rents are set to recover the lessor's costs of interest, municipal taxes and other costs that are absorbed elsewhere by the Government in the case of government-owned accommodation.

7.50 A distinction must be made between simple leases in which ownership remains with the lessor and lease agreements which provide for transferring ownership to the government at the end of the term. Lease-purchase agreements are clearly an alternative

method of acquiring property. Although lease-purchase has a significant impact on the annual costs of government as compared to construction or purchase, all are simply different methods of acquiring ownership of accommodation. This would be better recognized if lease-purchase arrangements were also financed through the capital appropriations of Public Works.

7.51 The appropriate accounting for such leases is currently being debated in the private sector. Where the lease is substantially equivalent to an instalment purchase, it is suggested that the cost of the property and the related liability should be recorded at the present value of future payments under the lease. Tests that would establish the lease as being equivalent to a purchase, include:

- the lease term approximates the building's useful life;
- there is an option to acquire the property at a value substantially less than its fair value at the time;
- the property being acquired has to meet special needs of the lessee; and
- the lessee has guaranteed the obligations of the lessor.

If these conditions apply in the case of government lease-purchase arrangements, the expenditure should be recorded as a charge to the capital appropriation just as if it were an outright purchase. This will result in consistent accounting for capital acquisitions based on the substance of the transaction rather than on the form. Exhibit 7.4 shows how lease-purchases might be disclosed in the Estimates.

Exhibit not available

7.52 The effect of this proposal would be to record the lease-purchase arrangement as an expenditure in the Accounts of Canada in the year it is entered into, with the offsetting liability being recognized as a form of borrowing. Present practices inform Parliament inadequately of the capital costs of accommodation, as illustrated in paragraphs 3.59 to 3.62 of Chapter 3 of this Report where the effect of the leasing arrangements on the building occupied by my Office is shown.

Managing the Department - the Accommodation Management and Professional Services Revolving Fund

7.53 If the system suggested above is accepted, the Department will be receiving income from:

- professional fees charged to the Department's capital vote, or to the capital votes of other departments, based on professional fee schedules; and
- realty management fees charged to the Building Operations Revolving Fund based on prevailing commercial fee rates.

7.54 The establishment of a second revolving fund, the Accommodation Management and Professional Services Revolving Fund, would permit the Department to use the income of this Fund to meet all departmental overhead costs, excluding only those payments to third

parties for individual buildings that would be charged directly to the Building Operations Revolving Fund. These overhead costs are now borne by the operations votes and statutory items of the Administration, Professional and Technical Services, and Accommodation Programs, which would no longer be required. Exhibit 7.5 illustrates how the operating budget of such a fund might be presented.

Exhibit not available

7.55 In addition to providing design and construction management services for projects in the Department's own capital vote, Public Works also provides the same services for projects carried in the Estimates of other departments, for example, the Penitentiary Service's prison complexes and the crime labs and detachment quarters of the Royal Canadian Mounted Police. The Department does not now attempt to recover its costs for these services beyond certain extra expenses such as the cost of travel to the site.

7.56 If a revolving fund were established to cover Accommodation Management and Professional Services, the costs of advisory services should also be charged to the users with provision for payment being included in their capital votes. If rates for professional advice are based on provincial fee schedules, the Department would be obliged to use the private sector if its own costs are not competitive.

7.57 If this procedure was followed, the ability of the Department to function efficiently would be reflected directly by the status of the Accommodation Management and Professional Services Revolving Fund. Should Department costs exceed income, the resulting deficit in the Revolving Fund would require it to return to Parliament for an appropriation. Excess revenue over the authorized limit of the Fund at the end of the fiscal year, however, should be paid into the Consolidated Revenue Fund.

7.58 Exhibit 7.6 is a schematic chart illustrating the relationship between the capital votes and revolving funds discussed above.

Exhibit not available

Revenue Dependency

7.59 The Department of Public Works advocates a system of revenue dependency. If the system discussed in this Chapter is adopted, it is evident that the Department's ability to operate within its revenues would depend on its ability to contain its operating costs within the revenues generated from service charges. Since income would be based on current, fair market rental rates, the Department's costs could not be simply passed on to the user. If the revolving funds incur deficits, the Department will have to request an appropriation from Parliament to cover them.

7.60 The proposed system would make the Department of Public Works truly revenue dependent. Assuming continued inflation, the Building Operations Revolving Fund would likely become profitable in time since its revenue would be based on current market value, while the capital portion of its costs would remain constant for existing buildings. The separate Accommodation Management and Professional Services Revolving Fund, to which most departmental costs would be charged, would have to keep its costs within the revenue generated from market determined fee schedules. The existence of two revolving funds would

prevent inefficiencies in the latter operation being offset by inflation-induced excess revenues in the Building Operations Revolving Fund.

7.61 There is, of course, a danger under revenue dependency that the Department, if faced with a deficit, might attempt to reduce costs by reducing the quality of its services. However, it can also choose to contract out its services for the same fees as it earns. The revenue dependency concept allows this type of latitude.

7.62 The concept of two revolving funds is the key to providing adequate accountability. If charges to departments are based on market values, they should not complain about being charged for the quantity and quality of the services they demand. Public Works, at the same time, can be held fully accountable for the efficiency and effectiveness of the common services it provides. Levels of spending by the Department that exceed revenues would have to be justified in terms of special costs unique to government. Excess costs due to inefficiency should prompt consideration of more efficient ways of providing services or a greater use of the private sector.

Conclusion

7.63 There is little doubt that objections will be raised to the proposals we have advanced; objections based on the notion that all the fundamental benefits of improved disclosure and better accountability for the costs of accommodation, can be achieved without the necessity of the ultimate step of actually charging departments for the space they occupy. Theoretically there is some truth in such a position; a truth that would be acceptable to this Office if we were able to discover evidence that, during the long and protracted debate, such improvement had been made. The opposite is the case. The tentative first steps, taken in 1962, of showing even notional costs of accommodation by department have since been abandoned. The history of this issue is clear evidence of the fact that the actual levying of charges for accommodation is the key that will unlock the door to other needed improvements. The proposals we have advanced are designed to give Parliament a better understanding of the full costs of all departmental programs as well as an improved means of assessing the efficiency and effectiveness of Public Works as a provider of common services.

7.64 Subsequent to the completion of our study, the Standing Senate Committee on National Finance released its exhaustive report on the Accommodation Program of the Department of Public Works. We are gratified that our two Reports advocate essentially the same things.

1978 Report of the Auditor General of Canada - Chapter 8

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Departmental Comptrollers</H1>
</CENTER>

<HR>

8.1 In my 1976 annual Report, I reported that:

"... in my judgment, the two actions at the central level of government of establishing the position of Comptroller General and appointing to it the right person are of paramount importance in achieving the ultimate objective of sound financial control throughout government, they should be paralleled eventually in every department, agency and Crown corporation that is accountable to the Government and to Parliament for the effective and efficient management and control of public funds."

8.2 These two actions have been taken. The position of Comptroller General has been established and a person with outstanding qualifications has been appointed as the first incumbent. These moves should have significant impact in achieving sound financial control throughout government.

8.3 The parallel action required in departments, agencies and Crown corporations has not yet been widely acted upon. We also reported last year that the President of the Treasury Board elaborated on government policy by stating that, in almost every case, the senior departmental financial officer should report directly to the deputy head or equivalent. In addition, we suggested that such officers should preferably be designated as the Comptroller (in combination, if appropriate, with another designation such as Assistant Deputy Minister in departments or Vice-President in Crown corporations) and should have prescribed authorities that are fully commensurate with their key duties and responsibilities.

8.4 These views are supported by the conclusions of the Standing Committee on Public Accounts, which stated in paragraph 7 of its Third Report dated June 29, 1978:

"(a) a senior full-time financial officer is required and should report directly to the head of the organization and should be a full-time member of the management committee in order that financial management takes its proper place in the decision-making process.

(b) stronger financial direction and leadership are required of senior financial officers in departments, agencies and corporations to ensure that the quality of financial administration throughout the organization is maintained at an acceptable level."

Conditions Prerequisite to the Effective Functioning of Departmental Comptrollers

8.5 Our last year's Report reemphasized our recommendation on the conditions that should exist if Departmental Comptrollers are to play the role envisaged for them. That Report, in paragraph 8.33, stated:

"To function effectively, the senior departmental officer responsible for financial management and control in departments and agencies must:

- have the financial function as his main concern;
- report directly to the deputy head and be a member of the senior management committee; and
- have the training, experience and range of responsibilities to act as the deputy head's adviser on financial management and control concerns and to provide the necessary leadership to all staff with financial responsibilities in the department."

8.6 The recommendation seeks to establish firmly the organizational conditions necessary for ensuring that the system of financial administration within each agency and department meets the needs of the head of each agency and department, the senior program staff and the central agencies.

8.7 The audit findings of this Office and actions reported in updated responses to the Financial Management and Control Study recommendations to individual departments, agencies and Crown corporations indicate some progress in bringing about the required changes. However, our position in this regard is still not universally understood and accepted. This lack of progress is unfortunate, since it tends to retard the development of effective departmental systems of financial management and control. Thus, it may be helpful in this connection to expand in summary form on the conditions outlined in paragraph 8.5.

8.8 The first condition outlined above is that the Departmental Comptroller should have the financial function as his main concern. Where the financial function is one of many diverse functions of a senior administrative officer, the possibility exists that adequate time and attention will not be devoted to finance. Under this type of arrangement, not only may the senior administrative officer lack the time to exercise his control responsibilities adequately, but managers of the organization may perceive the role of finance to be one of service only. In these cases, communication of concerns over control weaknesses may not be given appropriate priority. In large organizations, financial management should be the Departmental Comptroller's sole responsibility. In smaller or less complex organizations, he may be able to devote some time and attention to administrative duties, but these should not detract from his financial control responsibilities.

8.9 The second point above is that the Departmental Comptroller should report directly to the deputy head and be a member of the senior management committee. In most large-scale enterprises, the role of the senior financial officer consists of a complex and difficult blend of responsibilities involving the provision of advice and financial services to all levels of management while also ensuring, on behalf of top management, that adequate financial controls exist throughout the organization. In many government departments and agencies, the control aspect of the senior financial officer's function has been subordinated to the service aspect. Thus, for the foreseeable future, it will be necessary to place much greater emphasis on

this officer's control responsibilities. This will require strong support from the department or agency deputy head and is one of the principal reasons we are recommending that there should be a direct reporting relationship between the Departmental Comptroller and the department or agency deputy head.

8.10 This relationship would also give adequate recognition to the organizational arrangements necessary for effective communication of financial advice and control concerns to the deputy head and senior management. The President of the Treasury Board, the Honourable Robert Andras, expressed agreement with this principle in a House of Commons debate on December 9, 1976.

8.11 The third condition for the Departmental Comptroller to function effectively is that he should have the training, experience and range of responsibilities to act as the deputy head's adviser on financial management and control concerns and to provide the necessary leadership to all staff with financial responsibilities in the department. Financial management expertise and experience are required to ensure that the myriad of financial management and related issues are handled effectively and that sound advice is provided to the deputy head and senior management. Professional accounting training is normally considered the most appropriate method of acquiring the necessary degree of specialized accounting knowledge. This knowledge can then be expanded over the years through experience in progressively more responsible positions involving the direction of financial management and control functions.

Responsibilities of the Departmental Comptroller

8.12 To provide effective advice and financial leadership, the role of the Departmental Comptroller should encompass a broad range of responsibilities. Our 1975 Report summarized these as follows:

"Senior departmental financial officers ought to be given responsibility for:

- providing budgetary, accounting and financial reporting services;
- ensuring that adequate financial controls exist over all assets and financial transactions;
- advising and supporting deputy heads and their staff in all matters pertaining to financial management and control;
- developing, monitoring and controlling budgetary allocations through analysis of financial reports and ensuring the adequacy of the systems used in their preparation; and
- furnishing technical direction and guidance to all personnel within departments responsible for these duties.

8.13 The Financial Management and Control Study revealed that both financial officers and program managers hold a narrow perception of the scope of responsibilities of financial officers. For Departmental Comptrollers to undertake effectively the broad responsibilities outlined in the previous paragraph, there must be active acceptance by deputy

heads and senior managers of the need for greater accountability for public funds and the vital role of their senior financial officers in assisting them to exercise this accountability.

8.14 Departmental Comptrollers should be actively involved in designing and evaluating the adequacy of financial management and control systems, even in areas where others are responsible for operation of these systems. This is not meant to diminish the responsibility or authority of other managers; rather, it seeks to ensure that the systems and procedures, designed to serve their needs, include the financial control features required to ensure the reliability and integrity of financial data and the safeguarding of the assets entrusted to their care.

Relationships of the Departmental Comptroller

8.15 The suggestion that the title of Departmental Comptroller should be used for the senior financial officer in a department emphasizes the uniquely important role of this key individual in developing and maintaining effective systems of financial management and control and serving as the principal adviser to the deputy head on all financial matters. There appears to be some confusion surrounding the use of this title. This may, in part, be due to an erroneous comparison with the role of the former Comptroller of the Treasury, whose function was discontinued some years ago, or to a comparison with positions carrying a similar title in various industrial and commercial firms.

8.16 To correct any impressions of this nature that may still exist, it may be helpful to clarify the relationships that we envisage between the Departmental Comptroller, his deputy head and the Comptroller General. As stated previously, he should have a direct reporting relationship to his deputy head in providing the advice and financial services discussed earlier in this section. He should also have a functional relationship with the Comptroller General. These would be complementary rather than conflicting relationships, designed to ensure that the department's system of financial management and control meets both its needs and those of the central agencies.

8.17 The functional relationship between senior departmental financial officers and the Financial Administration Branch of the Treasury Board has been the subject of considerable discussion, but no guidance has yet been forthcoming. The appointment of the Comptroller General should provide the impetus needed to develop these functional relationships, which we suggest should take the form of advice and guidance from the Comptroller General and his senior staff, as required, on such matters as:

- the most effective organizational arrangement for the financial function in a given department;
- the selection, training and career development of financial staff;
- the appropriateness of departmental budgetary control, financial reporting and financial control systems; and
- interpretation of regulations, directives and guidelines with financial implications issued by central agencies.

8.18 This list is included to illustrate the nature of the functional relationships that should exist between the Comptroller General and the Departmental Comptrollers. It should not, however, be construed as an exhaustive list of such relationships.

8.19 In summary, the Departmental Comptroller, as a key member of the most senior management group, should be the individual to whom his managerial colleagues would look for guidance on all financial matters. He would be the one best qualified by training and experience to provide this advice and to provide the systems and controls appropriate to the scale and complexity of the programs administered by departmental managers at all levels.

Organizational Concerns Requiring Further Study

8.20 The Financial Management and Control Study identified and made recommendations to correct a number of deficiencies in the organization of the financial function within departments and agencies. Our continuing work in this area emphasizes the need to deal with a number of organizational concerns centering around the Departmental Comptroller's role and responsibilities in the areas of:

- long-range planning;
- developing Program Forecasts;
- designing and evaluating the control components of large financial operating systems including their computerized aspects;
- developing and operating management control systems, including those relating to efficiency and effectiveness measurement and to project reporting;
- determining the contents of departmental Estimates and Public Accounts; and
- reviewing service and core program costs on a regular basis.

8.21 Many of these areas require interaction and co-operation between financial staff and program managers. It is essential that Departmental Comptrollers play an active role in these matters so deputy heads can be satisfied that financial management concerns have been properly addressed and all alternatives have been fully explored and evaluated. A number of factors, including the extent of the decentralization and complexity of a department's operations, can affect the nature of the involvement and the degree of responsibility such officers assume. These issues will require further study before specific recommendations can be made on how they should be dealt with in relation to individual departments.

8.22 At the same time, a number of fundamental issues are involved concerning the extent to which a Departmental Comptroller, as a senior staff adviser to his Deputy Minister, should become involved in matters that in some departments at least, have traditionally been considered the responsibility of others. I believe these are matters on which they need the support and guidance of the Comptroller General and which, therefore, should be addressed by his Office as early as possible.

8.23 Should any further clarification of the views expressed in this Chapter be required, the importance of the subject suggests that the deputy head concerned should initiate

discussions on the matter with the Comptroller General as a priority matter. Our Office stands ready to provide any further information desired on this vital subject by the deputy head, the Comptroller General or, of course, by the Standing Committee on Public Accounts.

1978 Report of the Auditor General of Canada - Chapter 9

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Contracting Procedures</H1>
</CENTER>

<HR>

Introduction

9.1 In 1976 we initiated a special study of the practices followed across government in entering into and administering contracts. The objective was to determine whether contracting arrangements for construction and for the acquisition of goods and services are entered into with appropriate authority and with due regard for economy in the spending of public funds and are consistently administered in compliance with all relevant statutes, regulations, policies, directives and guidelines. We performed an examination and review to determine the adequacy of departmental internal control systems and procedures regarding the contracting process, from the preliminary request through the procurement activity to the final payment. We examined a representative sample of contracts to determine the degree of adherence to internal control systems and procedures. The examinations were carried out at the Departments of Communications, Consumer and Corporate Affairs, Environment, National Defence, Post Office, Public Works, Secretary of State of Canada, Supply and Services and at Defence Construction (1951) Limited.

9.2 The study was completed during 1977-78 and reports were issued to each department and Crown corporation detailing our observations and recommendations. In this Chapter we present a general report on multi-departmental or government-wide issues that emerged in the course of our review. This is followed by condensed reports, highlighting points of interest and observations on contracting in the departments and the Crown corporation examined during 1976-77 and 1977-78.

Government-Wide Issues

9.3 Competitive tendering. Section 8 of the Government Contracts Regulations requires that tenders be invited before entry into contract except where the need is one of pressing emergency, estimated expenditure does not exceed \$15,000, it is not in the public interest to invite tenders, or only one person is capable of performing the contract. This provision reflects the basic procurement policy of the Government, which is to best satisfy specific program requirements and use the competitive process wherever feasible to achieve the basic objectives of best value and fairness in the expenditure of public funds.

9.4 The value of contracts awarded on an exception basis is greater than that of contracts awarded competitively for most types of government procurement. At the Department of Supply and Services, for example, of 181,941 contracts valued at \$2,788 million placed during 1976-77 for which the selection method is identified in its contract information system, 89,659 contracts totalling \$1,821 million are categorized as sole source, selected source or no substitute.

9.5 In the absence of competitive tenders, there is not the same assurance that the Crown has achieved the objective of best value in awarding a contract. Fairness is not defined in the policy and guidelines on Contracting in the Government of Canada but is considered to be reflected in the policy statement that within the limits of practicability, all qualified firms shall have an equal opportunity to compete for government contracts. The statistics quoted above for the Department of Supply and Services and findings in other departments indicate that the opportunity for formal competition does not exist for a significant portion of government procurement. In addition, there is not always evidence of adequate justification for exceptions in accordance with Section 8 of the Regulations where selection is not made competitively. Although a degree of competition may exist for much of that procurement, there is no assurance of fairness where formal, open competitive procedures are not used.

9.6 *The Treasury Board and all departmental contract approval authorities should ensure that submissions for approval to enter into a contract give some details of the basis on which the contractor was selected. Where the selection was not made competitively, the submission should clearly state the relevant part of Section 8 of the Government Contracts Regulations under which the exception is requested and the particular circumstances justifying the inclusion of the proposal in that category of exception.*

9.7 Pricing and payment terms. In setting the terms and conditions of contracts, departments are responsible for ensuring that the Crown's interests are adequately protected, that the method of pricing employed is the one most appropriate to ensure best value and effective cost control and that the terms and conditions are consistent with all applicable statutes and regulations. Where mutually satisfactory firm prices cannot be established or the procurement lies in a field where the practice is not to quote firm prices, a variety of other pricing methods are used. There are often problems associated with the use of these other methods.

9.8 With fixed-time rate and cost-plus pricing methods, there is often no incentive for the contractor to control his costs; indeed, there may be a positive incentive for him to maximize hours spent or costs incurred. To achieve some measure of cost control under these pricing methods the contract should provide for monitoring the time spent and costs incurred relative to the progress of the work and for comparing actual performance to pre-determined target levels. As such contracts usually provide for progress payments, a cost control regime can be incorporated into the payment approval process. Provisions for cost control are not always included in contracts; where they are included, they are not always integrated with the payment provisions.

9.9 In approving proposals to enter into contract, the Treasury Board is not usually informed of significant details in the proposed contract and so may not become aware of deficiencies in the terms and conditions.

9.10 *Contracts employing fixed-time rate and cost-plus pricing methods should contain appropriate cost control provisions integrated with the payment terms.*

9.11 *For contracts requiring its approval, the Treasury Board should be made aware of significant terms and conditions.*

9.12 Approval authority. The Government Contracts Regulations establish dollar limits beyond which the approval of the Treasury Board is required to enter into or amend contracts.

Instances were noted at the Department of Public Works and at Defence Construction (1951) Limited where, because of a perceived urgency, contractors were instructed to begin work before Treasury Board approval was received. At departmental approval levels, more frequent instances were noted at these and other departments where work was started, and in some cases *completed, before departmental approval was obtained and a contract signed.*

9.13 *When circumstances require work to begin before entry into a formal contractual arrangement, the instructions to the contractor should be in writing and should include a statement of the work to be performed before formal approval is obtained and an interim pricing basis, payment terms and financial limitation. Where the required financial limitation is in excess of the departments approval authority, Treasury Board approval should be obtained for the action taken.*

9.14 Departmental delegations of authority. The Guide on Financial Administration contains the guidelines to be followed in delegating financial signing authorities and the directives departments must observe in this regard. There were significant deficiencies in some departmental systems for delegating and documenting signing authorities. In the Department of Public Works, such deficiencies resulted in contracts being amended without appropriate authority and in a lack of documentation of the exercise of authority. In the Department of Supply and Services, numerous instances were noted of improper redelegation to subordinates of signing authorities by incumbents of positions.

9.15 *Departmental financial manuals should give clear direction on the proper procedures to be followed in documenting both the delegation of signing authorities and the exercise of such authorities.*

9.16 Commitment authority. No contract may be entered into or have any force or effect unless a certificate as to the availability of funds has been given pursuant to Section 25 of the Financial Administration Act. This Section also requires that a record be kept of all commitments.

9.17 A number of instances were noted of contracts being entered into or amended without prior certification of the availability of funds. Where contract expenditures were expected to extend over more than one fiscal year, the certifications did not always distinguish between the amount available from current year appropriations and the amount to be provided in subsequent years in some cases certifications were given without reference to a stated dollar value or any financial limitation.

9.18 In some departments examined, commitment control records and procedures were not adequate to ensure that departments' contractual commitments were properly reflected.

9.19 *Appropriate procedures to record and control contract commitments should be implemented and enforced.*

9.20 Payment of contractors' accounts. Systems for processing payments on contractors' accounts must, like all payment processing systems, satisfy the requirements relating to certification for payment under Section 26 and spending authority under Section 27 of the Financial Administration Act as well as the Account Verification and Payment Requisition

Regulations. There were some weaknesses in design or operation of these systems in all departments examined. As a result of these weaknesses, payments were made:

- for which all requisite authorities were not obtained;
- that did not conform to the terms of the contract;
- that exceeded the financial limitations of the contract;
- for which there was not adequate evidence of the receipt of goods or services or the performance of work;
- for which all essential items of documentation were not obtained;
- which resulted in the overpayment or duplicate payment of accounts;
- which were not properly certified under Section 27 of the Act; and
- for which there was no evidence that the required verification had been performed.

9.21 *Spending and payment authorities should be exercised only when payments are in accordance with contract terms and conditions and after evidence that account verification procedures have been thoroughly applied.*

9.22 Recommendations aimed at correcting the above deficiencies and other weaknesses identified during the study have been included in the individual reports to the departments and the Crown corporation and are summarized in the remainder of this Chapter. We have been advised that, in most cases, corrective action has been taken or is being implemented. Follow-up to ensure the effectiveness of corrective action taken will be carried out as part of our ongoing audit activities.

Communications

9.23 A study at the Department of Communications was performed during 1976-77 and 1977-78. Forty-four contracts totalling \$2.8 million were examined to determine the effectiveness and adequacy of contracting procedures and controls.

9.24 A departmental directive issued in March 1976 designated the Contract Review Board as the departmental authority for contract approval originating within the Department. The Contract Review Board is composed of the Deputy Minister and Assistant Deputy Ministers, the Directors General of Personnel and Administration and of Financial Services and Program Review.

9.25 In general, our study did not reveal major weaknesses in laid-down procedures and controls. The deficiencies noted were the result of non-adherence to these procedures and controls as well as a lack of clear direction in the departmental directive on contract administration. The deficiencies have been communicated to the Department and steps were taken to resolve the weaknesses referred to below.

9.26 Financial signing authority. Commitment certification pursuant to Section 25 of the Financial Administration Act and authority to initiate an expenditure are required from authorized officers before entry into a contract. We noted that this type of authority was being exercised for computer services by departmental officers who were not, in all cases, authorized to do so.

9.27 *Financial signing authority for requisitions for computer services should be exercised only by officers with the appropriate delegated authority and it should be the responsibility of the Accounting Services Section to ensure that this is the case.*

9.28 Administration of contract requests. A departmental directive sets out the procedures for processing contract requests including Contract Review Board approval and completion of departmental checklists.

9.29 Departmental requirements for contract electronic data processing services are being referred to Computer Services, but are not being presented to the Contract Review Board for approval and departmental checklists are not being completed. Furthermore, the departmental directive does not provide direction for processing amendments to contracts.

9.30 *Contract proposals for electronic data processing services should be referred to the Contract Review Board for approval and the checklists called for by departmental policy should be completed.*

9.31 *The departmental directive should provide direction for processing amendments to contracts.*

9.32 Sole source selection. The Treasury Board Policy and Guidelines on Contracting in the Government of Canada provide for the allocation of responsibility between client departments and common service agencies calling for quotation on contracts. They specify that "the overall contracting phase" is the responsibility of the Department of Supply and Services. The Policy and Guidelines state the circumstances and conditions under which departments may request entry into sole source procurement.

9.33 In a few instances, departmental requests did not duly record the justification for or properly justify sole source procurement in accordance with the Treasury Board Policy and Guidelines.

9.34 *All sole source procurement contract requests should be properly justified and such justifications recorded.*

Consumer and Corporate Affairs

9.35 We evaluated the procedures that the Department of Consumer and Corporate Affairs is using in contracting for supplies and services. In February and March 1977, we examined 17 contracts totalling \$400,000 to verify the effectiveness of procedures and controls. The weaknesses found in the Department's management of contracting were attributable generally to a lack of adherence to contracting guidelines. The results of the study were presented to the Department and our recommendations for remedial action have been accepted.

9.36 Research and development contracts. The Treasury Board's guidelines, issued in April 1977, concerning contracting out the government's requirements in science and technology, state that the Science Centre of the Department of Supply and Services is responsible for all contracting. These guidelines have not been incorporated into the Department's financial administration manual.

9.37 *The Department's Product Safety Branch entered into a number of contracts involving research of a scientific nature without having the Science Centre arrange the contracting.*

9.38 *The Department's financial administration manual should direct that science and technology requirements be referred to the Science Centre of the Department of Supply and Services for procurement.*

9.39 *The guidelines governing these government contracting policies and procedures should be incorporated in the Department's financial administration manual.*

9.40 Sole source contracts. In a number of cases it was observed that bids were not invited when it was decided by the contracting authority that only one source was available without seeking the professional advice provided by the Department of Supply and Services. While we are in general agreement with a departmental study which recommends that the contracting authority seek advice from professionals within the Department on possible contract sources, the professional contracting facilities of the Department of Supply and Services provide a much broader base from which to invite contracts on a competitive basis.

9.41 *Procedures should be implemented to ensure that sole source contracts are entered into only after having sought the advice of the Department of Supply and Services.*

9.42 Oral arrangements. Senior officers of the Department have, on occasion, entered into oral arrangement, with contractors directing them to proceed with assignments before notifying the Finance and Administrative Directorate of the contractual arrangements or obtaining certification of the availability of funds as required by Section 25 of the Financial Administration Act.

9.43 *When circumstances require work to begin before entry into a formal contractual arrangement, the instructions to the contractor should be in writing and should include a statement of the work to be performed before formal approval is obtained and an interim pricing basis, payment terms and financial limitation.*

9.44 Contract controls. The Finance and Administrative Directorate of the Department has promoted the use of certain standard clauses in contracts to protect the Department's interest and strengthen contracting practices. In many contracts, "required clauses" have not been included. Also, modifications of the standard clauses are not communicated to the Directorate to ensure the Department's interests are adequately safeguarded.

9.45 *Where there is a departure from using the Department's standard contract form or there is a deviation from the "required clauses" listed in the financial directives, the exceptions and variations should be referred to the Legal Branch before the contract is submitted to the Finance and Administration Directorate for processing.*

Defence Construction (1951) Limited

9.46 Defence Construction (1951) Limited was incorporated in 1951 to contract for major military construction and maintenance projects required by the Department of National Defence. The Corporation's principal functions in the field of construction management are to obtain tenders, either make recommendations regarding proposed awards or make the award themselves, and then administer approved contracts.

9.47 Our examination during 1977-78 included a review and evaluation of the procedures followed in the awarding and administration of construction, maintenance and service contracts. We reviewed a selection of 139 contracts with a total value of \$1,300 million at the Corporation's Ottawa Headquarters.

9.48 In general, the Corporation's contracting is well organized and effective. The weaknesses found in some areas were attributable to a lack of clearly defined policies and procedures and a failure, in some respects, to adhere to legislative and regulatory requirements.

9.49 Competitive tendering. It was noted that, where closing dates were extended, there was no evidence on file that the facts of each case had been presented fully and no evidence of extension approval.

9.50 In some cases where contract quotations exceed funds approved for the project, the Department of National Defence may change the specifications and request a revised price. If the change is substantial, at least the three lowest tenderers are requested by the Corporation to submit revised prices. On lesser changes, the Corporation exercises judgment on whether only the lowest tenderer be requested to submit a revised price. The Corporation has no clearly formulated, written policy to ensure that tenderers are consistently and fairly treated and that the economic benefits of competition are realized.

9.51 *The Corporation's Administration and Procedures Manual should include policies and guidelines respecting:*

- *the extension of tender closing dates;*
- *mandatory information on tenders; and*
- *retendering where plans or specifications are changed before award of contract.*

9.52 Award of consulting contracts. The Corporation has no written policy and procedures for selecting consulting contractors or architectural, engineering and survey services. The manner in which consulting contractors are selected by the Corporation does not give all qualified firms an equal opportunity to compete and does not comply with Section 8 of the Government Contracts Regulations. There is no assurance that contracting is conducted in a manner that reflects fairness in the spending of public funds.

9.53 *The Corporation should develop written procedures for the selection of consultants based on Section 8 of the Government Contracts Regulations and the guidelines provided by the Treasury Board.*

9.54 It was noted on some files that the contract demand and the contract were dated subsequent to the contractor's invoices for the completed work. Two cases were noted where the design consultants were instructed to begin work before the Corporation obtained the requisite Treasury Board approval to contract. The formal agreements in each case contained a clause providing for the earlier effective date of the work.

9.55 *When circumstances require work to begin before entry into a formal contractual arrangement, the instructions to the contractor should be in writing and should include a statement of work to be performed, before formal approval is obtained, and an interim pricing basis, payment terms and financial limitation. Where the required financial limitation is in excess of the Corporation's authority, Treasury Board approval should be obtained to issue instructions to the contractor.*

9.56 Pricing and payment terms. Appropriate cost control provisions are not always included in contracts; where they are included, they are not always integrated with the payment provisions. Cost control provisions become particularly important where a fixed-time rate pricing method is used.

9.57 *The Corporation should maximize the opportunity for effective cost control by incorporating cost control provisions into the payment terms.*

9.58 Payment of contractors' accounts. An examination of the procedures and documentation employed in processing payments disclosed a lack of compliance with regulations and internal control procedures. For example, it was noted that signatures do not appear on the cheque requisition forms and the certification required by Section 26 of the Financial Administration Act is not performed by a financial officer.

9.59 *Procedures for processing payments of contractors' accounts should be revised to conform to legislative and regulatory requirements and to improve financial control.*

Environment

9.60 Our review and evaluation of the procedures and practices followed by the Department of the Environment in the letting of contracts covered 1976-77. We examined a selection of 211 contracts with a total value of \$6.3 million. The study was carried out at the Headquarters offices of Fisheries and Marine Service, Environment Management Service, Atmospheric Environment Service and the Administration Program. As well, the Environmental Protection Service and Environmental Management Service of the Western and Northern Regional Office were included. In each of the locations tested, there were a number of weaknesses found in the system of internal control over contract expenditures.

9.61 The results of the review were reported to the Department. We have received departmental responses for all of the specific observations raised in our report. Evidence provided to us indicates that departmental Headquarters is seriously attempting to correct the cited weaknesses in internal control. The more significant findings are reported below.

9.62 Improper payments on contracts. We found examples of payments made on contracts for goods not covered by the contracts, payments without proper authority for the expenditures, payments for services performed after the contract expired and payments for expenses claimed without supporting evidence. As an example of the last situation, on one six-

year contract totalling \$517,000, quarterly payments were made without the Department requiring the recipient to account for the expenditures. In this case, we have been informed that an annual statement accounting for expenditures is now obtained.

9.63 *In order to correct the above deficiencies, the Department should ensure that no payment is made against a contract:*

- *unless authorized by the terms of the contract;*
- *for any period after the expiration date; and*
- *unless supported by appropriate evidence.*

9.64 Requisitions issued after work performed. In a number of instances, we noted that work under contract had been performed and billed to the Department before the requisition had been issued and the contract let.

9.65 *When circumstances require work to begin before entry into a formal contractual arrangement, the instructions to the contractor should be in writing and should include a statement of the work to be performed before formal approval is obtained and an interim pricing basis, payment terms and financial limitation.*

9.66 Failure to audit service contract costs. Though some service contracts provide for an audit clause, no audits of such contracts had been performed in the cases we examined.

9.67 *To ensure that contract billings include only proper charges, audits should be carried out periodically. In each instance where an audit would not otherwise be made, a responsible officer should review the file and satisfy himself that the circumstances do not warrant conducting an audit.*

9.68 Other internal control weaknesses. Our study disclosed the following examples of other weaknesses relating to payments on contracts:

- lack of evidence of pre-audit;
- lack of cancellation of original supporting documents;
- expenditures charged to the wrong fiscal year; and
- inadequate control over signing authorities.

9.69 A memorandum outlining general requirements of pre-audit, and addressing each of the above issues, was issued by the Assistant Deputy Minister, Planning and Finance, to Senior Assistant and Assistant Deputy Ministers and the Directors of Administration.

National Defence

9.70 During 1977-78 we performed a review in the Department of National Defence of the financial policy, records and procedures on contracting. We examined a sample of 35

contracts with a value of \$s million at several units at National Headquarters and further samples at the Canadian Forces Bases Comox and Moose Jaw.

9.71 As a result of our examinations, we are of the opinion that control of contracting and compliance with contracting regulations and other requirements of the Government of Canada are generally satisfactory, although some significant deficiencies in procedures were noted, as outlined in the paragraphs that follow. These have been reported to the Department and steps have been taken to resolve them.

9.72 Commitment control. Commitment control was being exercised at the management account level rather than at the project level, which is the level required in order to provide the information necessary for issuing commitment certificates under Section 25 of the Financial Administration Act. Several projects had been over-committed at the project level, but there were no over-commitments at the management account level. Departmental policy now requires the control to be exercised at the project level.

9.73 *The Department should maintain commitment control at the project level.*

9.74 Expenditure control. Certain employees at National Defence Headquarters units whose signing authority under Section 26 of the Financial Administration Act is limited to \$50,000 per account, as specified in a departmental financial directive, had been signing cheque requisitions regardless of the amount. The units have now been directed to comply with the requirements of the directive.

9.75 *The limitations set out in the departmental financial directive should be adhered to.*

9.76 Officers signing under Section 26 of the Financial Administration Act were giving a certificate that all verification procedures required by the Account Verification and Payment Requisition Regulations had been carried out without the benefit of:

- certain of the procedures required by the Regulations (Sections 5 and 7) having been incorporated into the Department's instructions applicable to this area;
- documented evidence indicating that all the steps of the account verification process had been carried out; and
- specimen signature cards for verification of signatures given under Section 27 of the Financial Administration Act, which in some instances, were either missing, outdated or incomplete.

9.77 *The departmental financial directive should be amended to include all verification procedures required by the Account Verification and Payment Requisition Regulations. Further, all specimen signature cards should be maintained on a current basis.*

9.78 Advertising contracts. The Department entered into certain contracts for advertising services for recruiting military personnel without inviting tenders as required by Government Contracts Regulations.

9.79 *The Department should adhere to the Government Contracts Regulations.*

Post Office

9.80 In 1977-78, we carried out a review and evaluation of procedures followed in the award and administration of contracts in the Post Office Department at Headquarters, three district offices and two mail processing plants. A selection of 67 contracts with a value of \$132 million was examined. The deficiencies found have been reported to the Department and steps are being taken to resolve the matters referred to in the following summary.

9.81 Contract splitting and renewals. Contracts were entered into where the contract amount was split into a series of smaller contracts which fell below the level requiring Treasury Board approval. Examples were noted where contracts had expired but additional services were provided without the contracts being formally renewed and Treasury Board authority being obtained.

9.82 *All officers involved in the contracting process should be instructed that authority limits set by the Treasury Board must not be circumvented by splitting similar departmental requirements that could normally be covered by one contract into a series of smaller contracts. In addition, proper procedures should be put in place for the renewal of contracts before their expiry dates and to ensure that Treasury Board authority is obtained where necessary.*

9.83 Internal financial controls. Weaknesses in financial control over payments on contracts were identified in spending and payment authorities and in processing Department of Supply and Services (DSS) billings. The Post Office Financial Management Manual does not clearly define the responsibilities of the managers to perform the account verification procedures required by the Account Verification and Payment Requisition Regulations before exercising spending and payment authority under Sections 26 and 27 of the Financial Administration Act. Some responsibility centre managers were not performing account verification procedures.

9.84 Invoices covering purchases of DSS store items and fees for services as purchasing agent are often processed without responsibility centre approval. Related billings are not verified to the rates and prices published by DSS and there is not a complete matching with receiving reports.

9.85 *The Post Office Financial Management Manual should be amended to delineate clearly the responsibilities of officers exercising spending and payment authority. Also, billings by the Department of Supply and Services should be verified with the rates and prices published by that Department and, as required, completely matched with receiving reports.*

Public Works

9.86 Our examination of the Department of Public Works included a review and evaluation of controls in six regional offices and five district offices of the Department. We examined 181 construction contracts, non-construction contracts and consultants' agreements with a total value of \$512 million.

9.87 Our review showed that there is a need for clarification and standardization of policies, revisions of existing documents and closer adherence to statutes, regulations and directives.

9.88 Delegation of financial signing authority. The Index of Authorities maintained by the Department does not clearly define the four authorities, i.e., approval, implementation, certification and signing authority which are used in the processing of contracting documents. It is not possible to determine from a signature on a document which authority is being exercised. The Department has now instituted a new manual of delegated authorities.

9.89 *The definitions in the Index of Authorities should be clarified and amended so as to remove any inconsistencies and to indicate whether any or all authorities are required and how the required authorities are to be evidenced.*

9.90 Appointment of consultants and tendering. The Policy and Guidelines on Contracting in the Government of Canada states that: "Within the limits of practicability, all qualified firms shall have an equal opportunity to compete for government contracts". It was found that tenders or proposals are not always being invited for agreements for architectural, engineering or other similar services in accordance with these policies and guidelines.

9.91 *The Department should develop written policies and procedures to substantiate reasons for not inviting tenders in the selection of architects and engineers as required by the Government Contracts Regulations.*

9.92 Account verification and payment. The procedures in the Department's Financial Management Manual and the instructions contained in ancillary departmental procedures are not sufficiently clear to ensure that change orders are properly authorized before payments are made. These include examining change orders for authorized signatures and ensuring that the proper Treasury Board authority has been obtained if the change order results in a contract increase in excess of \$250,000.

9.93 Individuals with spending authority in the National Capital Region are not obtaining all supporting documentation necessary for the account verification process. We noted instances where contractors' accounts were certified and processed for payment without the required Treasury Board authority, as well as several other financial control exceptions.

9.94 *The Department should amend its Financial Management Manual to ensure that the detailed procedures for processing payments on contracts are clearly set out as required by the Account Verification and Payment Requisition Regulations and the Financial Administration Act. Officers who have been delegated spending and payment authority should be kept aware of their financial responsibilities and the procedures that must be followed in the verification of contractors' accounts before their payment.*

9.95 Materiel at construction sites. The Management Fee Contract used by the Department of Public Works is not consistent with the Surplus Crown Assets Act, R.S., c. S-20, because it permits ownership of materiel, plant, tools and other items that become surplus at construction sites to be transferred to the contractor instead of reporting them to the Minister of Supply and Services who is responsible for the disposal of such items.

9.96 *The Department should amend the provisions in the Management Fee Contract to conform to the requirements of the Surplus Crown Assets Act and contractors should be required to account for all materiel, plant, tools and other items during and until completion of the contract when custody reverts to the Department for disposal under the Surplus Crown Assets Act.*

Secretary of State of Canada

9.97 In 1977-78 we performed a review and evaluation of the procedures followed by the Department of the Secretary of State of Canada in awarding and administering contracts. To verify the effectiveness of these procedures, we reviewed 54 contracts with a total value of \$1.7 million. These were selected from contracts that had been entered into during the 12-month period ended September 30, 1976, and covered a cross section of the Department's programs and divisions in Ottawa and one district office. The deficiencies found have been reported to the Department. The following summary identifies the specific weaknesses noted. The Department is currently restructuring its total commitment control system and is taking steps to resolve the other weaknesses referred to below.

9.98 Commitment control. The commitment control record system does not provide program and responsibility centre managers with timely and reliable data on the total undischarged commitments within their budgets. Contract commitments were posted or coded incorrectly, or were not always entered in the commitment accounting records. Month-end commitment and expenditure data entered into the memorandum system were not recorded in the financial reporting system until the following month.

9.99 *Instructions should be issued to ensure that all contract commitments are recorded in the commitment control records.*

9.100 *The contract commitment control system should be structured to accommodate the needs of program and responsibility centre managers and provide them with commitment data on a regular basis.*

9.101 *Inputs to the contract commitment control system and the processing of that information to the financial reporting system should be reviewed and revised to minimize errors and omissions and improve the quality of control and timeliness of the monthly reports.*

9.102 Oral arrangements. Departmental officers have entered into oral arrangements under which contractors were directed to proceed with work before the contracts were documented and signed.

9.103 When circumstances require work to begin before entry into a formal contractual arrangement, the instructions to the contractor should be in writing and should include a statement of the work to be performed before formal approval is obtained and an interim pricing basis, payment terms and financial limitation.

9.104 Financial authorities. Approval and certification of payments under Section 27 of the Financial Administration Act was sometimes made by officers without delegated authority or without satisfactory evidence as to the receipt of goods or rendering of services. In some cases progress or advance payments were made which did not meet the conditions of the contracts.

9.105 *The Finance Directorate should ensure that contract progress payments are made only where contract conditions have been met and that officers issuing certificates under Section 27 of the Financial Administration Act have been delegated the authority to do so under the Government Contracts Regulations.*

9.106 *A review should be made of the Materiel Division's Policy and Control Section's receiving practices to ensure that satisfactory written evidence of the receipt of goods or services under contracts is obtained from departmental receiving points before exercising spending authority under Section 27 of the Financial Administration Act.*

9.107 *Departmental copies of cheque requisitions relating to contracts should bear evidence that officers with duly delegated authority have approved the payment under Section 26 of the Financial Administration Act.*

9.108 Control of Receiver General cheques. Our examination disclosed that Receiver General cheques totalling \$174,394 were returned to program officers or responsibility areas participating in the negotiation of the contracts, to be forwarded on to the contractors concerned. In the majority of cases no explanations were advanced to support the reasons for returning these cheques to the program areas.

9.109 *Receiver general cheques payable to contractors should not be returned to program or responsibility centre managers requisitioning the cheques, except where there is no alternative, and only when exemption from the internal control mechanisms described in the Treasury Board Directive can be justified and proper controls exercised.*

Supply and Services

9.110 The Department of Supply and Services (DSS) was created in 1969 as a common service agency responsible for, among other things, the acquisition of goods and services for government departments and agencies. In carrying out this responsibility, Supply Administration, in 1976-77, placed 281,920 contracts with an aggregate value of \$2,800 million.

9.111 In 1977-78, our review and evaluation of contracting procedures in Supply Administration was carried out at each product centre in Ottawa and at all regional supply offices across Canada. We examined a selection of 780 contract files with a total value of \$1,100 million.

9.112 In general, contracting arrangements in Supply Administration are entered into with due regard for economy. There are, nevertheless, areas where economies could be effected and where administrative efficiency and control over payments could be improved. These are summarized in the paragraphs that follow.

9.113 Competitive tendering. Early delivery dates specified by customer departments and other constraints frequently result in non-competitive contract negotiations.

9.114 *Contracts for goods or services which might reasonably be expected to be awarded on a competitive basis but which are awarded without competition, for whatever reasons, should be identified during the approval process and analyzed so efforts to maximize competition can be concentrated on those areas likely to be most productive.*

9.115 To guard against possible interruptions of supply, contracts are sometimes issued to both the lowest and next lowest tenderers. In two instances noted in our review, the risk that this practice was intended to obviate was not clearly defined.

9.116 *Any deviation from normal procurement practice should be authorized only where risk has been defined and an analysis of alternatives has shown the suggested procedure to provide the best value in the circumstance.*

9.117 Standing offers. Master standing offers may be used by customer departments and agencies to requisition directly from suppliers at established prices without service charge from DSS. Alternatively, a departmental standing offer requires customer departments and agencies to requisition through DSS. Requisitions against a departmental standing offer become the basis for a DSS service charge to their customers and would also appear to require additional administrative effort. The Department advises that a rationalization study is under way.

9.118 *A policy and guidelines on appropriate use of standing offers need to be developed with particular attention given to departmental standing offers.*

9.119 The rate structure for billing customer departments for the cost of services does not reflect the Department's actual costs in handling very low dollar value purchases. The rate structure may encourage customers to place requirements less than \$100 through Supply Administration with consequent increased administrative costs. The position of the Department of Supply and Services is to provide service at the lowest total cost to Government.

9.120 *An examination of Supply Administration's costing and billing procedure should be made to establish a rate structure so charges for purchasing services will reflect the costs incurred.*

9.121 Pricing and payment terms. Appropriate cost control provisions are not always included in contracts; where they are included, they are not always integrated with the payment provisions. Cost control provisions become particularly important where fixed-time rate or cost-plus pricing methods are used.

9.122 *The Department should maximize the opportunity for effective cost control by incorporating cost control provisions into the payment terms.*

9.123 Certification of funds available. The wording on the requisition used by customer departments requesting DSS to procure goods or services is not sufficiently explicit to constitute unequivocal evidence that all the necessary certifications required by Section 25(1) of the Financial Administration Act and by the Appropriation Acts have been given. The Department is in the process of introducing a revised requisition on a trial basis.

9.124 *The wording of the signed authorization statement should clearly specify that all necessary certifications required by law have been given before proceeding with entry into a contract.*

9.125 The Department's customer manual provides for entering into contracts in excess of the funds provided for on a requisition, within specified limits. This practice is contrary to the requirements of Section 25 of the Financial Administration Act.

9.126 *All departments and agencies should be made aware of the importance of indicating on a requisition when the estimated costs provided for on that requisition are not to be exceeded.*

9.127 Requisitions under \$2 million do not detail the funding provided by fiscal year for goods or services for which payment will extend over more than one year.

9.128 *Where acquisitions are to be funded from appropriations to be provided over two or more fiscal years, the requisition should be revised to require a customer department or agency to specify the planned expenditure by fiscal year.*

9.129 Approval and signing authorities. In the absence of incumbents of positions with contract approval or signing authority, subordinates sometimes approved or signed contracts on an acting basis without proper authority. The Interim Supply Policy Manual of the Department does not define what constitutes a "proper" designation of persons authorized to carry out the duties of a position in the absence of the incumbent. The Manual does not provide instructions for the filing and retention of copies of designations for audit purposes.

9.130 *The Manual should define what constitutes "proper" designation and provide for the filing and retention of designations of authorized persons.*

9.131 The Department's Interim Supply Policy Manual requires that the exercise of approval authority be evidenced by a request outlining and justifying the proposed contractual action. Contrary to the Department's policy, such a request is not always completed for contracts and amendments submitted for approval below the division chief level.

9.132 *The exercise of approval authority at all approval levels should be evidenced in accordance with departmental policy.*

9.133 Depending on the required approval authority level and the originating product centre, the approval authority may see a typed copy of the proposed contract, a draft of the proposed contract or only the submission to enter into a contract. Including a typed master of the proposed contract would reduce the amount of detail required in the contract submission, subject the master contract to the quality control checks and provide more complete information to the approval authority.

9.134 *A typed master of the proposed contract should be submitted to the approval authority.*

9.135 Other control weaknesses. An examination of the procedures and documentation employed in processing payments on contracts disclosed weaknesses in compliance with regulations and in internal control:

- clerks certifying under Section 27 of the Financial Administration Act were either not qualified by virtue of position or were supervised by a person signing under Section 26;
- supporting documents did not routinely accompany invoices; and
- responsibility centre managers were responsible for the receiving, verification of accounts and cheque preparation functions which is contrary to Section 4 of the Account Verification and Payment Requisition Regulations.

9.136 *Procedures for processing payments in the Supply Administration should be revised to conform to legislative and regulatory requirements and to improve financial control.*

1978 Report of the Auditor General of Canada - Chapter 10

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Computer-Based Financial Systems</H1>
</CENTER>

<HR>

Introduction

10.1 In August 1976 the Audit Office initiated a government-wide Computer and Information Systems Evaluation (CAISE) Study to review and evaluate in depth the controls pertaining to electronic data processing (EDP) in the Federal Government. The results were reported in Parts 3, 4, 5 and 6 of the 1977 Report.

10.2 This Chapter reports on the status of the CAISE Study recommendations that have not yet been fully implemented. Each recommendation is shown in italics, identified by the paragraph number in the 1977 Report and followed by the present status of its implementation.

10.3 In general, the recommendations have been well received by the Treasury Board Secretariat and the Office of the Comptroller General and the departments to which they were directed. Progress in implementing them has been slow, due to the complex and time-consuming nature of the implementation process.

Report by the Standing Committee on Public Accounts

10.4 The Standing Committee on Public Accounts held six meetings on the CAISE Study findings and reported on those meetings in its Third Report to the House of Commons. (See Appendix E in this Report for the full text of the Third Report). The Committee found that there is a need for:

"(a) more effective management of EDP and control procedures at the departmental level;

(b) the Treasury Board Secretariat to provide directives, standards and a strengthened monitoring process in order to achieve consistency throughout government;

(c) improved security to protect equipment, programmes, and the classification of information both within the government and within the private sector contracting to the government; and

(d) more involvement of financial personnel in the development, operation, and audit of EDP financial systems."

10.5 The Committee further reported that the Treasury Board Secretariat and the departments basically support our recommendations and that steps have been taken to implement them. We have followed up the implementation process in our 1977-78 audit examinations and report, in the paragraphs that follow, on those not fully implemented as of June 30, 1978.

Management Control over EDP Resources

10.6 *The Treasury Board Secretariat should perform effective monitoring and evaluation of all major EDP development projects. (1977 Report - paragraph 4.15)*

10.7 The Treasury Board Guide on EDP Administration, as revised subsequent to the CAISE Study, includes provision for the Treasury Board Secretariat to select periodically significant projects for monitoring. The Secretariat has also established procedures covering the selection and monitoring of particular systems. However, in our view, the Secretariat's Information Systems Division still lacks the resources needed to carry out its monitoring effectively.

10.8 Proposed revisions to the Treasury Board Guide on Financial Administration call for involvement by the Office of the Comptroller General in monitoring EDP development projects as well as on-going EDP systems of a financial nature for compliance with Treasury Board directives and guidelines.

EDP Security

10.9 *Security standards and related procedures should be developed, published and enforced to:*

- *provide for the classification of data, including information on individuals, in appropriate categories; and*
- *establish the level of security required for each category of data. (1977, Report - paragraph 4.17)*

10.10 During the last year, the Security Advisory Committee, through its associated groups (the Interdepartmental Computer Security Panel, the Security Policy Under Review Secretariat and the Royal Canadian Mounted Police Security Evaluation and Inspection Team), initiated discussion papers as well as suggestions for Cabinet directives relating to the establishment of a classification level for "sensitive" information. The proposed policy and associated directives are currently under review by the Solicitor General and a decision is expected shortly on a Cabinet directive to classify data in this area.

10.11 Furthermore, the RCMP is currently drafting security standards to coincide with the anticipated new Cabinet directives. The draft standards have not yet been made available for review. The present plan is to issue them as part of, or as an addendum to, the Treasury Board Guide on EDP Administration.

10.12 *Immediate consideration should be given to implementing compensating control measures sufficient for ensuring that the security level of information processed at private sector computer service bureaus is not compromised, or to removing all classified information from those bureaus which have not been cleared to an appropriate security level. (1977 Report - paragraph 4.20)*

10.13 "Interim Security Guidelines for Procurement of EDP Services from the Private Sector" were issued in July 1978 by the Department of Supply and Services. We will review these guidelines in the course of our work.

Controls over Financial Information Processed by Computers

10.14 *Departments should clearly define the specific roles and responsibilities of departmental financial and data processing personnel for controls, and should ensure active participation by financial personnel in the specification, design and testing of computer systems and related controls. (1977 Report - paragraph 5.8)*

10.15 At present the Office of the Comptroller General is revising two chapters of the Treasury Board Guide on Financial Administration, which address this recommendation.

10.16 *Through the use of suitable training programs, financial and EDP personnel should be educated in their respective roles and responsibilities concerning controls in the development and on-going operation of computer systems. (1977 Report - paragraph 5.9)*

10.17 Significant progress can not be made in this area until the roles and responsibilities have been specified in sufficient detail. This is currently being addressed as a pilot project by a department in consultation with the Office of the Comptroller General. The Office of the Comptroller General is also evaluating various training courses that could be used for this purpose.

10.18 *The Treasury Board Guide on Financial Administration should be revised to include specific control standards and procedures for all financial information processed by computer systems and provision for effective monitoring of departmental compliance with these standards and procedures. (1977 Report - paragraph 5.10)*

10.19 Proposed revisions of the Treasury Board Guide on Financial Administration include the specific control standards and procedures recommended. Departmental compliance with the Guide in this area will be monitored after the proposed revisions are published.

Internal Audit Capability

10.20 *A comprehensive action plan should be developed to augment significantly the present internal computer audit capability in the Government. Such a plan should include an estimate of the computer auditing resources required together with plans for recruitment and training to develop those resources. (1977 Report - paragraph 5.12)*

10.21 The Comptroller General is currently assessing governmental internal auditing, including computer auditing, with the intention of developing departmental action plans which, where appropriate, will include the plans recommended.

10.22 *As part of its financial administration evaluation activities, the Treasury Board Secretariat should monitor to ensure that effective internal audits of computer-based financial systems are conducted on a regular basis. (1977 Report - paragraph 5.13)*

10.23 The Financial Policy Evaluation Division of the Office of the Comptroller General has established the monitoring capability recommended and has undertaken a number of evaluations.

10.24 We note that Chapter II of the Treasury Board Guide on EDP Administration, as revised last year, includes a directive to departments to establish the necessary EDP internal audit capabilities.

10.25 *Standards and related procedures for internal auditing in the computer environment should be established, published and enforced. These should be integrated with existing or planned standards for financial, management and security audits and should include requirements for:*

- *integration of the review of computerized aspects of systems and controls with other audit work;*
- *minimum levels of audit documentation for the computer portions of the system;*
- *use and control of computer-assisted audit techniques;*
- *evaluation of EDP security; and*
- *auditors trained in computer systems and related auditing techniques. (1977 Report - paragraph 5.14)*

10.26 We understand that the Office of the Comptroller General is publishing "Standards for Internal Financial Audit in the Government of Canada" which includes standards and related procedures for auditing in the computer environment. We also understand that an "Internal Audit Handbook" is being developed by the Interdepartmental Advisory Committee on Internal Financial Audit. Chapter 12 of this Report deals with departmental auditing activities in the Federal Government in more detail.

Financial Controls in Nine Major Computer-Based Systems

10.27 As part of the CAISE Study, controls over the processing of financial information in nine major computer-based systems in seven departments were subjected to an in-depth review and evaluation. The implementation of the recommendations arising out of these reviews is being monitored in conjunction with our normal audit work in the departments concerned. The status of those recommendations that had not been fully implemented as of June 30, 1978 is reported on in the remainder of this Chapter.

Department of the Secretary of State of Canada - Canada Student Loans System

10.28 *The responsibilities of the Supervisor, Accounts Sub-section and the Head of the Accounts and Administrative Section should be redefined to provide for effective segregation of duties. (1977 Report - paragraph 6.7)*

10.29 *Supervisory personnel should review the action taken in correcting exceptions reported in the Loan Sub-system and take appropriate action to ensure that all exceptions are properly dealt with. (1977 Report - paragraph 6.7)*

10.30 All position specifications have been rewritten to reflect the organizational changes necessitated by the recent transfer of the Canada Student Loans System from the Department of Finance to the Department of the Secretary of State of Canada. The segregation of duties and the review responsibility for action taken in correcting exceptions have been built into the new specifications for the positions concerned.

10.31 *Proper documentation, including documentation of the computer programs and all clerical procedures related to the systems, should be developed and updated on a current basis. (1977 Report - paragraph 6.8)*

10.32 A departmental study addressing the state of the documentation is now in progress, with September 1978 as the target date for completion.

Department of Finance - Provincial Revenue Equalization Payments System

10.33 *Computer program modification procedures should be established and adhered to, with particular emphasis on proper testing and evidence of approval of test results before implementing the modification.* (1977 Report - paragraph 6.12)

10.34 Computer program modification procedures have not been established. Since the completion of the CAISE Study, no program changes have been made and none is anticipated until the Federal-Provincial Fiscal Arrangements Act, 1972, 1972, c. 8 expires in December 1978.

10.35 *Proper documentation of the system, including documentation of the computer programs, and procedure manuals for the terminal operator and system users should be developed and updated on a current basis.* (1977 Report - paragraph 6.13)

10.36 Since the CAISE Study, a new Act (Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, 1976-77, c. 10) has become effective, while the old Act (Federal-Provincial Fiscal Arrangements Act, 1972) remains applicable until December 31, 1978. Our review indicated that the documentation for the system supporting the old Act has not been improved because of its imminent end. The documentation for the new system is still incomplete.

10.37 *The Department should take full advantage of the password protection available within the computer service bureau to reduce the likelihood of unauthorized access.* (1977 Report - paragraph 6.14)

10.38 Due to its imminent expiry, the system supporting the old Act has not been protected by password in the computer service bureau. We were informed that the new system is password protected.

Department of National Defence - Central Computational Pay System

10.39 *The Department should develop a computer equipment backup plan for the Borden and Ottawa Data Centres including the ranking of computer applications by "need-to-process" and also including provisions for the use of non-Department of National Defence computer facilities. Subsequently, the staff responsible for each application should plan how to use the backup arrangements and these plans should be subjected to tests.* (1977 Report - paragraph 6.17)

10.40 The Department of National Defence has implemented a "need-to process" survivability plan for all applications on the Ottawa and Borden Data Centres. Although the Department is working on an equipment backup plan for these two data centres, an overall computer backup plan still does not exist.

10.41 The CAISE Study was intended to identify weaknesses in internal controls and did not include the tests required to seek out specific instances of errors or irregularities. Accordingly, we are currently conducting an audit examination of the Central Computational Pay System whose scope is significantly expanded from that of the CAISE Study.

Department of National Revenue, Taxation - T-1 Processing Stream

10.42 *Formal system testing and acceptance standards should be established and enforced. These standards should include requirements for the preparation and approval of test plans, formal approval of test results and the comparison of predetermined accounting information with the results of tests.*

Particular attention should be given to defining clearly the role and responsibilities of users of financial accounting information in system testing. (1977 Report - paragraph 6.22)

10.43 The Department is currently drafting new testing guidelines which we will review on completion.

10.44 *The Finance Directorate should insist on readily accessible audit trails for all computer-generated posting summaries. (1971 Report - paragraph 6.22)*

10.45 The Department has agreed to implement this recommendation and is currently addressing the establishment of such audit trails.

10.46 *Batch controls over certain journal vouchers used to effect transfers of funds from the account of one tar remitter to that of another should be established from the point of origin until after processing, and checks for authorized approvals should be performed when such journal vouchers are entered into the computerized stream. (1977 Report - paragraph 6.23)*

10.47 The Department is currently addressing this recommendation. We will review its implementation on completion.

10.48 *Computer-produced debit or credit memos should be sent for verification purposes to a tar remitter automatically whenever there has been a charge or credit to an account. We understand that practical consideration may make it necessary to exclude certain housekeeping transactions from this procedure; however, such exceptions should be minimized. (1977 Report - paragraph 6.23)*

10.49 Our recommendation has not been complied with to date; however, we understand that the Department is planning to issue a policy statement in this regard.

10.50 *Planning should include a clear differentiation between systems development and systems maintenance. Costs incurred in each activity should be accounted for separately and should be planned, controlled and evaluated by the Systems Group and by user management. (1977 Report - paragraph 6.24)*

10.51 The Department records its EDP costs on a project basis rather than by separating costs between systems development and systems maintenance as suggested in our recommendation. The Department points out that the differentiation between these costs is extremely difficult and that current cost allocations satisfy Treasury Board Secretariat requirements. Nevertheless, we believe the adoption of our recommendation would improve the information provided to management in this area.

10.52 *Formal standards for performing, documenting and approving feasibility studies, for system testing and for project management should be established and enforced. Particular attention should be given to defining clearly the roles and responsibilities of the users in these processes. (1977 Report - paragraph 6.25)*

10.53 *The Department has identified the standards and is currently working on establishing procedures to enforce them.*

10.54 *Systems documentation should be improved so that a clear understanding of the effect of a transaction on all systems and sub-systems can readily be obtained by the Systems Group and user management. (1977 Report - paragraph 6.26)*

10.55 The Department is taking action to improve documentation of new systems and programs.

10.56 *To ensure continued computing capability, comprehensive plans and procedures should be developed, formalized and tested regularly to provide for the use of equipment, critical computer programs, data files and systems documentation in the event that the facilities at the Ottawa Data Centre are not available. (1977 Report - paragraph 6.27)*

10.57 *These plans and procedures should include off-site storage and regular updating of critical data, programs and systems. (1977 Report - paragraph 6.27)*

10.58 The Department is addressing our recommendation; however, the work is still incomplete.

Post Office Department - Cash Receipts and Money Order Systems

10.59 *Present reliance on computer programs should be supplemented by computer and manual balancing, covering reconciled as well as unreconciled items. This would ensure the integrity of the total amounts processed and thereby enable detection of discrepancies which may have passed unnoticed through the computer reconciliation programs. Furthermore, the facility to trace transactions through the systems should be improved to allow processed transactions to be tested periodically. (1977 Report - paragraph 6.31)*

10.60 Manual balancing procedures have been implemented which will eventually provide the degree of control envisaged by our recommendation. These manual controls will be applied until the necessary computer program changes have been made. The Department indicates it will make the changes when the required resources become available.

10.61 *Revisions to critical computer programs should be independently reviewed and approved for accuracy and validity before implementation. In addition, "live" files should not be used for testing purposes. Instead, special test files, with predetermined results and control totals, should be created for testing all such revisions. (1977 Report - paragraph 6.32)*

10.62 Although certain improvements have been made in controlling the procedures over changes to computer programs, the extent of these improvements does not fully satisfy our recommendation. The Department is continuing to make improvements in this area.

10.63 *Although some progress is being made in reducing delays, considerable restructuring of the Cash Receipts System is required to significantly improve the timeliness of verification and reconciliation procedures. We understand that the Post Office is planning to rewrite several of the system modules to incorporate improvements. The need for improved control in this area should be carefully assessed in determining the nature of the revisions and how soon they will be implemented. (1977 Report - paragraph 6.33)*

10.64 As indicated previously in paragraph 10.60, manual balancing procedures have been implemented; however, the computer-based investigation of discrepancies has not been implemented. The implementation of this recommendation is also subject to the availability of resources.

10.65 *Procedures for reconciling output reports to each other and to the general ledger should be developed and implemented to provide a check on the accuracy of the reports and to permit the use of computer records in support of accounting totals (such as the liability for money orders). This will*

require a major revision to the systems and its feasibility should be carefully assessed in conjunction with the existing revision plans. (1977 Report - paragraph 6.35)

10.66 *Present known differences between computer reports and general ledger totals should be investigated and corrected and consideration should be given to establishing specific accounting controls over outdated, uncashed money orders deleted from the computer system. (1977 Report - paragraph 6.35)*

10.67 The differences between computer reports and the general ledger totals have been reduced significantly to less than \$10,000. The Cash Receipts Division is confident of locating the difference when the manual reconciliations of the cash accounts are completed. Furthermore, feasibility studies are being carried out to determine the requirements to implement this recommendation fully.

Department of Supply and Services - Central and Regional Pay Systems

10.68 *Immediate steps should be taken to ensure that user departments are aware of their responsibility for controlling input documents submitted to the Department of Supply and Services, and that more effective batch-control procedures are implemented within the departments. (1977 Report - paragraph 6.40)*

10.69 Although some steps have been taken to make user departments aware of their responsibility for controlling these input documents, the controls over input remain weak. The Treasury Board Secretariat is aware of this situation and is taking further steps to improve the recommended controls.

10.70 *The Department of Supply and Services should continue to give priority to implementing improved batch-control procedures within the Regional Pay System. Moreover, interim measures of a practical nature should be taken to strengthen controls in the Central Pay System. (1977 Report - paragraph 6.40)*

10.71 Batch controls continue to require improvements. Since the Central Pay System is being phased out, we have not reviewed it to ascertain if its controls have been improved. However, we understand that a monitoring system has been set up in the Central Pay System to inform departments of instances where they are not adhering to established reporting procedures.

10.72 *The Financial Administration Act and its regulations should be clearly interpreted as they relate to pay administration. That interpretation should be enforced within every department. (1977 Report - paragraph 6.41)*

10.73 The Treasury Board Secretariat appears to have clearly interpreted the regulations of the Financial Administration Act with regard to the authorizing procedures (Treasury Board Circular 1977-37). However, the enforcement of these new regulations is weak and evidence of authorization is frequently not adequately established. We understand that the Treasury Board Secretariat is acting to strengthen this enforcement.

10.74 *Departments should provide the Department of Supply and Services with signature cards that are complete and accurate and the Department of Supply and Services should be informed as soon as a signing authorization is amended. (1977 Report - paragraph 6.42)*

10.75 A Treasury Board Circular addressing this recommendation has been issued (Treasury Board Circular 1977-41); however, departments appear to be slow in updating their signature cards.

10.76 *The implementation of procedures to provide more effective controls over the computer processing of transactions for both Regional and Central Pay Systems should be given high priority.* (1977 Report - paragraph 6.43)

10.77 Progress to improve procedures in this area continues to be required.

10.78 *Procedures should be enforced to ensure that financial officers and responsibility centre managers are performing their duties with respect to review, reconciliation and distribution of pay cheques and related reports.* (1977 Report - paragraph 6.44)

10.79 Although further procedures to facilitate implementation of this recommendation have been developed, there are indications of significant confusion in this area in the departments we visited. We understand the Treasury Board Secretariat is in the process of assessing departmental procedures in this connection.

10.80 During the last year, we attempted to assess the impact of the control weaknesses reported by this Office's Financial Management and Control Study and by the CAISE Study on the pay expenditures reported in the Public Accounts. We have been unable to complete this assessment and have outlined the reasons in Chapter 22 of this Report

Canada Employment and Immigration Commission - Benefit and Overpayment System

10.81 The follow up on our CAISE Study recommendations is contained in Chapter 14 of this Report. Generally, our recommendations are being addressed by way of studies and pilot projects.

1978 Report of the Auditor General of Canada - Chapter 11

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Comprehensive Auditing for Parliament a New Cyclical Approach</H1>

</CENTER>

<HR>

11.1 In this, the first of two chapters dealing with comprehensive auditing, we outline a new audit approach for the Audit Office. The objective is to provide Parliament with constructive comprehensive evaluations of departments, agencies and Crown corporations on a cyclical basis and to co-ordinate the audit activities of the Office with those of internal and other auditors in these entities. This approach evolves largely from the developments which have occurred in the Office during the last five years.

Background

11.2 Evolution of the Audit Office. Formally, the legislation dealing with the Audit Office had evolved very little from 100 years ago when the position of Auditor General was created, to the introduction of the new legislation in 1977. As with most government institutions, however, the Auditor General's role is defined not only by the letter of the law, but also by tradition and convention. Here there was some evolution, particularly in the area of matters reported to the House of Commons. Early in the 1950s the Auditor General, Mr. Watson Sellar, instructed his staff to be alert to what he termed "nugatory payments". In 1958, he began reporting items of this type in his annual Report as "non-productive payments". His successor, Mr. Maxwell Henderson, continued in this tradition.

11.3 The Independent Review Committee. When I was appointed Auditor General in 1973, I believed there was a need for a fundamental reassessment of the functions of the Office and for a definition of the direction in which it should move in the future. The Independent Review Committee on the Office of the Auditor General of Canada was commissioned in October 1973 to meet this need. In April 1975 its report, a landmark study, was tabled in the House of Commons. The Government, after considering the Committee's recommendations, incorporated most of them in a new legal mandate for the Office, the Auditor General Act, proclaimed as of August 1, 1977.

11.4 The Auditor General Act. The new Act defines the responsibilities and relationships of the Auditor General. It requires the expression of opinions on financial statements and annual reporting on cases where there is insufficient accounting for and control over public resources and where money has not been expended for purposes intended. In addition, the legislation specifically calls for reporting cases where money has been expended without due regard for economy and efficiency and where procedures established to measure and report effectiveness are unsatisfactory -- the value-for-money issues critical to the Government's management of public resources.

11.5 Constructive auditing. Traditionally, parliamentary scrutiny of expenditure control and performance focused on isolated examples of improprieties discovered during field audits based largely on the auditing of transactions. Review of these findings, often long after the event, tended to be time-consuming and controversial and did not necessarily facilitate a broader understanding of the strengths and weaknesses existing in the management and control of public funds or suggest possible remedies for underlying problems. Furthermore, transaction auditing by itself, rather than in the form of specific tests relating directly to identified weaknesses in financial control systems, became largely impractical

and non-productive because of the sheer growth in the size of the Government and the volume of its transactions.

11.6 In 1973 we adopted a new form for the annual Report which specifically included, under the "any other case" authority which was in the legislation at that time, items formerly identified as non-productive payments and other matters we thought should be referred to the House of Commons. Further, we recommended appropriate corrective action and included both findings and recommendations in our annual Report. We also invited responses from agencies and departments indicating planned corrective actions for inclusion in the Report.

11.7 The Office also adopted a more contemporary approach to auditing the systems-based approach -- and began special studies as a first step in accomplishing the broad-scope audit objectives and providing Parliament with a better understanding of the underlying problems and possible remedies.

11.8 Specifically, constructive auditing means going further than the traditional practice of reporting errors, deficiencies and procedural weaknesses. It means, in addition, recommending methods of rectifying shortcomings. It also means, in significant matters, including both our findings and our recommendations in our Report to the House of Commons. Furthermore, it means including in our Report the response of the concerned agency, department or Crown corporation. Finally, and most important of all from Parliament's standpoint, it enables the Audit Office to follow up and monitor on behalf of Parliament, the implementation of corrective actions agreed upon. This whole approach facilitates greatly the work of the Standing Committee on Public Accounts and has now become a vital and indispensable part of the whole audit and reporting process. Thus, a constructive audit approach generates maximum benefit from the audit effort and contributes to the establishment and maintenance of effective systems for the management and control of public funds.

11.9 Systems-based auditing. Under the systems-based audit approach, the nature, extent and timing of detailed audit procedures, including appropriate selective tests of the validity and integrity of transactions, is based on an organized study and evaluation of controls within a system to determine what reliance can be placed on the system to ensure effective planning and management of resources and to provide accurate information. Although some detailed testing of transactions is necessary to ensure that the identified controls are effective, this audit approach enables the auditor to concentrate the audit effort in areas where controls to assist in the conduct of government operations do not exist or are not operating properly. At the conclusion of the examination the auditor is in a position to point out the consequences of the weaknesses and recommend possible means of instituting corrective action.

11.10 Special studies. To develop and implement this constructive approach, the Audit Office undertook special studies with teams consisting of staff from within the Office and professionals obtained from the private sector under Executive Interchange agreements or professional service contracts. The first major study was the Financial Management and Control Study (FMCS), conducted in 1975 and 1976. It gave Parliament an overview of government-wide financial management and control systems including the organization of the financial function, the qualifications of financial administrators, the quality and usefulness of information for managerial and financial control purposes, and the effectiveness of internal financial audit. The key recommendation of this study helped to bring about the appointment of the Comptroller General of Canada in early 1978. This study also focused attention on the financial control of and by Crown corporations.

11.11 The second major study, the Computer and Information Systems Evaluation (CAISE) Study, reported in 1977, penetrated more deeply into controls in the electronic data processing environment.

In essence an extension of the FMCS, it represented the first in-depth evaluation of computer-based systems by this Office.

11.12 The most recent major government-wide study, the Study of Procedures in Cost Effectiveness (SPICE), included in this Report, represents an important first step in the area of value-for-money auditing. It points out where significant improvements are required in existing efforts to achieve economy, efficiency and effectiveness in government.

11.13 There have been other important special studies reported in this and previous Reports. Recommendations have been made to improve the quality of financial information for Parliament in the Estimates and in the Public Accounts. Recommendations to enhance the scope, quality and effectiveness of internal audit are included in the next Chapter.

11.14 Current objectives. The special studies have directed specific attention to the policies and procedures established by central agencies since these are fundamental to the effectiveness of systems throughout the Government. The Comptroller General is taking initiatives to provide leadership and assistance to departments so that they may improve in the areas of weak financial management previously reported. These studies have also served to increase the awareness and skills of staff within the Audit Office. As part of their terms of reference, teams carrying out special studies have been required to develop new methodology in their respective areas of interest and expertise.

11.15 The objective now is to diminish the reliance on special studies, to capture the concepts and techniques which have already evolved, and to move towards providing Parliament with constructive, comprehensive evaluations of individual departments, agencies and Crown corporations and of the Government as a whole. To maximize the effectiveness of this audit approach, a concept of cyclical reporting, described later in this Chapter, is being implemented. To ensure economical, efficient and effective auditing within the Government, the activities of the Audit Office will be co-ordinated with those of internal auditors wherever the scope and quality of their audit work is appropriate and sufficient.

Comprehensive Auditing

11.16 The FRAME concept. We are using the acronym FRAME to describe, in very simple terms, the methodology being developed for comprehensive auditing. FRAME provides a useful basis for summarizing the legal responsibilities of the Auditor General, the objectives of the comprehensive audit and the nature of the specialized staff resources required to conduct it. The acronym FRAME results from combining the first letters of the following five separate but inter-related facets of the comprehensive audit:

- Financial Controls
- Reporting to Parliament
- Attest and Authority
- Management Controls
- EDP Controls

11.17 Financial controls. Audit examinations will continue, in the manner of the Financial Management and Control Study, to evaluate the controls over revenues, expenditures, assets and liabilities, including

the organization of the financial function, and the financial reporting and accounting systems. Considerable progress has already been made in incorporating the related audit methodology into the Office's continuing audits.

11.18 Reporting to Parliament. This module of the comprehensive audit considers the reports prepared both by the Government and by the Audit Office. On the government side, attention will focus on the form and content of submissions and reports prepared for requesting funds and for accounting to Parliament for money received and spent - the Estimates and the Public Accounts respectively. Until recently, the primary interest of the Audit Office in this area has been directed to expressing an opinion on the summary financial statements of the Government included in the Public Accounts. We now intend to place more emphasis on examining the consistency and adequacy of information on departmental programs and activities in both the Estimates and the Public Accounts.

11.19 The other aspect of reporting to Parliament concerns the annual Report of the Auditor General and the responsibility for deciding on principal issues and the appropriate emphasis to be given to each. In developing the comprehensive auditing approach and planning for its application, it will be necessary to plan the broad framework of annual Reports several years in advance. This module will also deal with the detailed reports the Office issues to government managers and which subsequently form the basis for summarized findings and recommendations in the annual Report.

11.20 Attest and authority. This module of the comprehensive audit constitutes the type of auditing traditionally carried out by legislative auditors - the examination of financial authority for government expenditures and related disbursements and the expression of an opinion as to the fairness of the presentation of financial information in accordance with stated accounting policies or, where appropriate, generally accepted accounting principles.

11.21 Management controls. This module deals with the Government's systems, policies and procedures for evaluating and reporting on the effectiveness of programs and for promoting the economic acquisition and efficient use of resources. Essentially it is value-for-money auditing, a development in government auditing that is rapidly gaining increasing emphasis in Canada. The current methodology in this area is still somewhat diffuse. It is really only beginning to emerge and be captured in a body of knowledge. Chapters 2 to 5 of this Report, dealing with our Study of Procedures in Cost Effectiveness, refer to the nature of the audit criteria which must be established as part of the audit methodology. This is a complex area, not only because it is a relatively new field of auditing, but also because effective implementation requires the use of multi-disciplined staff.

11.22 EDP controls. As a one-time study, CAISE accomplished its desired objective of producing an evaluation of the adequacy and effectiveness of controls in the electronic data processing environment of the Government. Methodology for evaluating EDP related controls and applying computer-assisted audit techniques is well developed in Canada, but there are few readily available practitioners with the necessary specialized qualifications. The ultimate objective is to have regular audit teams undertake computer auditing just as for all other facets of the comprehensive audit. In the meantime, this aspect of the audit will be carried out mainly by centrally directed teams of specialists operating in close collaboration with the regular audit teams.

11.23 An integrated approach. Comprehensive auditing does not imply five different audits, each dealing with one of the facets reflected in the FRAME concept. Experience to date, particularly with the special studies, leads us to conclude that, to be most effective, there can be only one audit of each entity. Although the audit criteria established for each module of the audit must be different, a uniform and integrated approach to audit planning, execution and reporting is necessary.

11.24 It would be extremely difficult for any one person to be an expert in all facets of the comprehensive audit. However, the key people in the Office, the management team associated with each audit, will be required to gain a sufficient knowledge of all aspects of the audit so they can identify issues and resource requirements, manage their assignments and assume ultimate responsibility for the reporting of conclusions. Not only will this result in more effective auditing, but it will also, we are certain, be appreciated by the entities we audit. These entities will be able to deal with one or a small number of the members of our senior management group in connection with the audit, not with a frequently changing group of staff assigned from our special study teams.

Cyclical Reporting

11.25 We believe that the reporting of comprehensive audit findings, with both positive and negative observations, for each of the entities we audit will enable Parliament to gain a better understanding than may now be possible of the general effectiveness of their operations and controls systems.

11.26 Careful consideration has been given to the reporting implications associated with our concept of comprehensive auditing. We have concluded that cyclical reporting would be the most effective and appropriate manner in which to report our findings to Parliament. Comprehensive audits conducted and reported annually for all of the entities we audit would not allow for effective reviews by Parliament, would not provide a reasonable interval for managers to demonstrate the effectiveness of actions taken to correct problems previously reported on and would require excessive Audit Office resources. Four years, the anticipated average life of a Parliament, would seem to be an appropriate interval between comprehensive reports designed to enable Parliament to evaluate the general quality of the financial and management control systems within each entity audited and would be a reasonable period over which to assess the trend of improvement, where such has been indicated in an entity.

11.27 The concept of cyclical reporting does not imply that an entity will be audited only once every four years. A minimum level of auditing will be required in all government entities each year to satisfy legal requirements, including the expression of opinions on annual financial statements. In instances where a comprehensive evaluation indicates that an entity falls well below acceptable standards, continuing audit coverage will be required to report on the situation and the nature of corrective actions taken by management. Significant matters arising from our audits will always be reported to Parliament on a timely basis. Furthermore, the reporting on each entity may be the product of auditing efforts extending over two, three or even four years.

Co-ordination with Other Auditors

11.28 Internal auditors As pointed out in the next Chapter of this Report, there is a significant amount of various types of internal auditing in the Government. Co-ordination of these audit activities both within the Government and with the Audit Office can achieve important economies and more effective results by eliminating duplicate and overlapping efforts. Co-ordinated audit efforts would also cause fewer disruptions in the organizations being audited.

11.29 We can place reliance on the work of internal auditors where we conclude that the scope and quality of their examinations are sufficient and appropriate. Unfortunately, the findings of our current review of internal audit preclude us from doing so in many departments at this time. This Report includes recommendations which, if implemented, will assist in establishing internal audit groups capable of carrying out effective, independent, integrated, comprehensive audits. We shall continue to monitor and report on the activities of such groups as part of our own audits and, in due course, we hope to be able to rely on their work to a greater extent.

11.30 Other auditors Our relationship with auditors, other than internal auditors, is not as significant an issue but it does warrant further consideration. First, other auditors have been appointed to audit certain Crown corporations. The Auditor General Act provides that we may rely on these auditors and that we may have access to information in these corporations should it be necessary to fulfil our responsibilities. Second, under the provisions of certain cost-sharing and transfer-payment programs, there are situations where we may find it desirable to rely on the audit work of provincial auditors general and they on the work of our Office. In developing the comprehensive audit methodology, we shall ensure that these relationships are appropriately and satisfactorily defined.

Crown Corporations

11.31 Our 1977 Report indicated that we intended to apply the same audit standards to the audits of Crown corporations and to discharge the same reporting mandate in terms of scope for all other government entities dependent in whole or in part on the public purse. This position has been endorsed by the Standing Committee on Public Accounts. In its Second Report to the House of Commons dated April 11, 1978, the Committee recommended that the standard of audit and accountability for public funds spent by corporations should not be less than that required of the Government itself. We plan to implement the comprehensive audit approach in all Crown corporations which we audit. For those we do not audit, we shall initiate discussions on the scope of audit examinations conducted by their external auditors, with particular reference to the Financial Controls and Management Controls (value-for-money) areas of comprehensive auditing.

Conclusion

11.32 Advanced Studies in Comprehensive Auditing Methodology. Significant progress has been made in developing audit methodology. As reported in previous years, the Office has prepared a uniform audit manual and provided extensive training to staff based on the concepts embodied in this manual. The present task involves updating and revising the manual, particularly in the area of value-for-money auditing, to ensure that it is applicable to all aspects of the integrated comprehensive audit. Professional development courses are being expanded and strengthened to provide for advanced studies in comprehensive auditing methodology and its practical application in all aspects of our work. In addition, we are preparing a Guide to Comprehensive Auditing Methodology as Developed and Applied in the Office of the Auditor General of Canada.

11.33 Practice. Integrated comprehensive auditing and cyclical reporting are now being introduced by the Office despite the lack of a complete methodology. The findings, observations and recommendations arising from several exploratory integrated departmental audits conducted during the last year are summarized in Chapters 14 to 19 of this Report. These reports must, however, be regarded more as illustrations than complete examples of the type of comprehensive report we expect to give Parliament in the future as we make further progress towards our ultimate objective of performing the comprehensive audits described in this Chapter.

1978 Report of the Auditor General of Canada - Chapter 12

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Comprehensive Internal Auditing Within Government a Recommended Approach</H1>

</CENTER>

<HR>

Introduction

12.1 This Chapter, the second on comprehensive auditing, discusses the need for improvements to enhance significantly the quality of internal auditing in departments and agencies. Internal auditing in departments is separate and distinct from audits carried out by the Audit Office on behalf of Parliament, sometimes described as external auditing. Without the benefit of integrated, comprehensive internal auditing, senior government managers can have no real assurance that they are obtaining value for money and are managing resources effectively. Three actions are needed:

- integration of the wide variety of audit, review, inspection, monitoring and evaluation activities now taking place within departments;
- adherence to generally accepted standards or norms for effective audits; and
- management support and leadership both centrally and within departments.

The government will receive adequate value for the approximately \$50 million departments now spend annually on audit activities only if these improvements are made.

12.2 Because of its size, dispersed operations and delegation of authority to managers, the Canadian government must have an effective internal audit. With all the competing demands on their time, deputy heads cannot themselves guarantee the integrity of their management systems. They need an effective internal audit capable of assisting them in assessing the systems and controls they use to manage the resources for which they are responsible.

12.3 Internal auditing may be defined as an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. There are various types of audits but they differ mainly in their scope. All have one thing in common: they are systematic investigations or appraisals of procedures or operations to determine conformity with established and sensible criteria. The criteria may not always be established where auditors venture into newer fields. If not, the first task of the auditor is to establish the scope by identifying the criteria he will use. Without a common understanding on audit criteria the audit findings are likely to be disputed.

12.4 It is important to realize that what we strongly recommend here is a totally new concept of the internal audit function. Until now it has been largely a fragmented function operating at relatively low levels without much recognition by senior management. A comprehensive approach to internal audit, like that outlined in the previous Chapter, when properly organized and led, can be one of the sharpest and most effective tools available to management. In this Chapter, we first examine how the present situation developed and then describe what needs to be done.

Evolution of Auditing Within Government

12.5 Situation before the Glassco review. Internal auditing was minimal in the Government of Canada until 1962 when the Glassco Commission reported. Departmental managers apparently saw little to be gained from an internal audit when the Comptroller of the Treasury could "be likened to a policeman patrolling the departments to ensure financial rectitude", as Glassco described it. The relatively few internal audit groups existed only in such departments as National Defence, where operations were decentralized and investigations had revealed weaknesses in controls, or National Revenue, where operations were chiefly financial in nature.

12.6 During the war years, the Comptroller of the Treasury established a Cost Inspection and Audit Division. By the time of the Glassco review in 1961, this unit was called the Audit Services Division (later the Audit Services Bureau) although it continued to be primarily engaged in verifying the accuracy of contractors' records. It also carried out internal audits as a service to some departments.

12.7 Glassco recommendations and their implementation. The Glassco Commission saw a greater need for internal audit as a corollary to its proposal to eliminate the independent pre-audit of the Comptroller of the Treasury; it favoured departmental audit groups rather than a central service; and it called for an interdepartmental committee to develop audit personnel and to improve audit standards and procedures.

12.8 In 1966, the Treasury Board, as part of the process of implementing the Glassco Commission recommendations, stated a policy on operational auditing and incorporated it in the Guide on Financial Management. Operational auditing differs from financial auditing in that management controls are examined not just financial controls. This policy was a constructive step, but it began the proliferation of internal audit activities because many departments, in seeking to implement the policy and give internal audit a higher profile, established operational audit groups separate from those conducting financial audits.

12.9 In 1969, Parliament ended the independent pre-audit of the Comptroller of the Treasury and departmental managers became fully responsible for their expenditures. In that same year, amendments to the Financial Administration Act transformed the Comptroller of the Treasury's audit group into a central service, as one of the components of the Services sector of the new Department of Supply and Services. The Audit Services Bureau has expanded greatly since 1971 when cost-recovery was introduced and departments have been able to obtain its services almost on demand, thereby permitting managers to buy auditing off-the-shelf without the necessity of giving careful thought to their real needs.

12.10 Actions since 1969. The elimination of the independent pre-audit of the Comptroller of the Treasury removed the principal means by which central agencies such as the Treasury Board ensured compliance with their rules and regulations. No longer could these agencies have any confidence that departmental managers adhered to the financial and other rules that they had prescribed. In the absence of an effective system of sanctions for poor management, the Treasury Board sought other means for evaluating departmental adherence to the Government's policies. Groups within each branch, and often even within divisions of the Treasury Board Secretariat, undertook reviews of departmental compliance with their policies. At the same time, the Treasury Board Secretariat established a new Planning Branch to promote, among other things, performance measurement and the evaluation of program effectiveness.

12.11 The Treasury Board also gave the Planning Branch responsibility for co-ordinating all evaluative efforts, including internal audit which it largely neglected. Because of this neglect, the Guide on Financial Administration, issued by the Administrative Policy Branch in 1973, unlike its 1966

predecessor, dealt only with financial audit (except for a guideline calling for the financial audit to be part of any operational audit or management review function) thereby unnecessarily restricting the scope of auditing previously established.

12.12 Financial Management and Control Study. Although Government policy since Glassco recognized internal audit as an important element in the managerial control process, this Office's 1975 Financial Management and Control Study found that: some departments had no internal audit function; internal auditors were often diverted to other duties; coverage was not consistent or comprehensive; and staff was not sufficiently trained or familiar with its responsibilities. The 1975 Report recommended, and the Government accepted, that:

"The central agency of the government responsible for prescribing the standards, scope and coverage of departmental financial audits should give greater emphasis to monitoring departmental internal audits so as to encourage greater adherence to the standards".

12.13 In response, the Treasury Board initiated a review of financial audit activities in government departments and the Office of the Comptroller General recently issued a booklet entitled Standards for Internal Financial Audit in the Government of Canada which substantially expands on the direction given in the Board's Guide on Financial Administration.

Purpose of Current Review

12.14 Our 1977 Report announced that the Audit Office would be undertaking a review to assess whether the Government gets value for money in the whole area of auditing within the federal structure. Our interest is twofold:

- To co-ordinate the activities of this Office fully with those of other auditors in the Federal Government, it is necessary to review the scope and quality of their work and to determine the extent to which this work can be relied on, thereby avoiding unnecessary duplication.
- To report significant instances where expenditures are not made with due regard to economy and efficiency and where satisfactory procedures are not in place to measure and report on the effectiveness of government programs, this Office must review internal auditing which is one such procedure. For this reason we reviewed not only the work of groups involved in internal financial audit, but also of those performing a much broader range of auditing, commonly referred to as "operational audits", "management audits" or "cost effective audits".

12.15 Our review began with extensive research into current internal audit practices in both the private and public sectors and was followed by pilot studies in selected departments. The complete review encompassed the auditing activities in 35 government departments and agencies.

Need for Integration of Departmental Audits

12.16 Partly as a result of the varying directions received from the Treasury Board, many departments at the time of our study had several groups involved in unco-ordinated audit activities.

12.17 Financial audits. Some departments separate the financial audit from other audits, often placing it under the senior officer responsible for financial administration. Such units are useful in ensuring that financial rules are followed, but they lack, or are perceived to lack, the independence to question the appropriateness of the financial rules themselves, let alone how financial controls relate to other management control systems. Generally, financial audits by departmental auditors and the Audit Services Bureau are undertaken by personnel who have had auditing training.

12.18 The gulf between financial and other audits is even greater when departments engage the Audit Services Bureau to conduct financial audits. When these audits are undertaken by auditors who are not part of the department, such as Audit Services Bureau staff, co-ordination of all audit work as well as reviews of audit findings and departmental follow-up tend to get less attention.

12.19 Operational audits. Operational auditors generally have quite varied backgrounds, but do not necessarily have training in auditing as a discipline. The areas they audit depend to a large extent on their skills and interests, as well as the interests of the persons to whom they report. Operational audit groups tend to be established at more senior levels and they sometimes report to deputy ministers even when the financial audit group does not. Although the Audit Services Bureau has established a capability to provide operational audit services to departments, departmental staff conducts most operational audits.

12.20 Program evaluation. Resources devoted to planning and evaluation have grown greatly in recent years. With the encouragement of the Treasury Board, most departments have created separate units which combine planning and evaluation activities. We did not review these groups in the same depth as audit units but generally they are staffed with persons who, despite having excellent academic qualifications, have little or no training in auditing. As a result, the policy planning side of their responsibilities receives most attention while evaluation has been spasmodic and the disciplined approach, characteristic of trained auditors, is frequently lacking. It is also questionable whether they can objectively evaluate plans they have been instrumental in creating or reviewing.

12.21 Use of Audit Services Bureau. Of the approximately \$50 million departments spend on auditing each year, about \$20 million is contracted out primarily to the Audit Services Bureau of the Department of Supply and Services. The origin of the Bureau was outlined earlier in this Chapter.

12.22 Departmental reliance on the Audit Services Bureau tends to restrict their initiative in integrating all internal audit activities. Although there may be a requirement for a central agency to provide audit services to departments on an occasional basis, we believe that auditing is an inherent responsibility of the department and that each department should establish a well balanced and competent internal audit group capable of carrying out a comprehensive audit.

12.23 A side benefit of auditing can be obtained if the internal audit function is an integral part of departmental operations and is used to expose bright, young staff to the department's operations and to broaden the horizons of middle managers who, through specialization, may have gained only a narrow perspective of management's problems. Use of the Audit Services Bureau limits opportunities for this type of training. Both external and internal auditors in the private sector have found that a fairly high turnover of staff is essential to maintain an effective audit organization by providing room for fresh ideas. Good people are attracted to auditing for the opportunity it gives to obtain an insight into a wide variety of operations, and to develop skills in fact finding, analysis and reporting.

12.24 Effectiveness of these audits. All these audit activities subject a line manager to review by many groups who may often be poorly co-ordinated. Each may have a narrow perspective of the nature of

management's problems and those to whom they report may have too limited authority to act on the problems identified. Assigning responsibility for all audit activities to a single senior official reporting directly to the deputy head would: attract leaders with appropriate management training; provide a proper balance between specialist and audit skills; and permit management's problems to be addressed in the broadest possible fashion.

12.25 Other evaluative activities. Line management of departments carry out monitoring and control activities, such as a review of field operations or of projects under a program to determine needs and subsequently assess adherence to laid down policies and procedures. Central agencies also subject departments to many types of similar reviews. Such activities, which may resemble audit, are not independent and are part of the normal management process. However, a clear distinction is often not made and those being audited feel they are over-audited. This has two unfortunate effects: on the one hand the primary responsibility of line managers to appraise systematically the performance of their programs and subordinates may be obscured; and on the other hand truly independent audit investigations may appear to be unnecessary. More effective and better coordinated internal audit would relieve the need for some of the reviews line management now conduct and at the same time provide the benefit of audit objectivity.

Present and Desirable Audit Practices

12.26 In conducting our review, we established certain audit criteria to assess our findings. We developed what we consider are reasonable and feasible standards that internal audit groups should meet, taking into account the "Standards for the Professional Practice of Internal Auditing" recently issued by the Institute of Internal Auditors. The Institute is an international association dedicated to the continuing professional development of internal audit.

12.27 The findings of our review have been communicated to departmental management. No department satisfied all the criteria we used. The chapters in Part 2 of this Report dealing with specific departments identify the current internal auditing situation in departments selected for comprehensive reporting to Parliament. In this Chapter we present the criteria or standards used in conducting this year's study, and against which we will evaluate departments in future when conducting comprehensive audits for Parliament. Departments selected for comprehensive reporting are identified where they have taken positive steps to meet what this Office regards as acceptable standards.

12.28 Present and desirable audit practices are described under the main needs:

- broadly defined responsibilities;
- well planned audits;
- proper organizational status;
- competent audit resources;
- professionally performed audit work;
- clearly reported audit findings; and
- effective audit committees.

We first state, in italics, the criteria or standards we would expect and then discuss the remedies needed, with some illustration of what we found.

12.29 Scope of responsibilities. *Internal audit should provide senior management with a continual, independent appraisal of all aspects of a department's activities.*

12.30 Our study leads us to conclude that the internal audit group should examine and evaluate all aspects of a department's activities including systems for ensuring:

- the integrity of financial and other information;
- controls over public property, revenues and expenditures;
- compliance with objectives, policies, plans, procedures, laws and regulations; and
- management with due regard for economy, efficiency and effectiveness.

In summary, the scope of internal audits should be unrestricted.

12.31 The responsibilities of most departmental internal audit groups are not defined and in certain instances the internal auditors do not adequately plan their audits to cover all significant aspects of the department's activities. These circumstances, coupled with staffing and other organizational problems, often lead to inconsistencies in the scope of audits and certain areas are never audited. In some departments the audit scope is consciously restricted.

12.32 As examples of unrestricted scope, three departments, National Health and Welfare, National Revenue - Customs and Excise and the Canada Employment and Immigration Commission, have defined the scope of internal audit well. They are in the process of implementing mandates for their internal auditors which aim at giving senior management an independent objective assessment of: the efficiency, economy and effectiveness of operations; the degree of compliance with financial and administrative policies and procedures established by the ministers and deputy ministers and by central agencies; and the integrity of the information used to acquire public funds and account for their expenditure.

12.33 Audit planning. *Audit planning should ensure that all activities of the department are identified, potential audit areas ranked in order of priority and appropriate audit objectives determined for each area selected for audit.*

12.34 To effect improvements in audit planning:

- a model of the department should be prepared identifying all organizational components, programs and activities, and revenue from outside sources when applicable, as potential audit areas and the audits should be planned to avoid gaps or duplication in audit coverage;
- the model should be updated at least annually;
- all potential audits should be assessed according to defined criteria based on materiality, importance to management and degree of risk or opportunity; and

- the objectives and scope in each area subject to audit should be established and an annual work plan prepared.

12.35 Our study revealed that many departments do not review their operations in sufficient detail to identify all activities that should be subject to audit.

12.36 Very few departments pay more than lip service to determining priorities based on materiality, the importance to management and the degree of risk. Frequently, the major audit effort is directed towards activities representing a small proportion of the department's expenditures with the result that audit findings may be of little significance.

12.37 There is a general lack of stated objectives for carrying out audits. In many instances, an area is audited simply because "it has always been done". There is a tendency to choose the easiest thing to audit rather than to venture into complex or sensitive areas requiring high skill levels or representing substantial risk. Consequently, internal audit groups seldom play a constructive role in assisting in the management of departmental resources.

12.38 The Department of National Health and Welfare recently prepared a model which identified and weighed the importance of over 100 auditable units and from this a six-year audit plan was developed, a commendable approach. The ranking process is vital for obtaining value for money in auditing.

12.39 Organizational status and mandate. *The internal audit group should have an organizational status that will permit it to report objectively and effectively on any operation or activity of the department. Its responsibilities should be clearly communicated in a mandate from the deputy head that demonstrates visibly his support.*

12.40 For internal audit to be effective:

- The head of the internal audit group should report directly to the deputy head and thereby be organizationally independent of all operations audited.
- Internal auditors should not plan, design, install or operate systems that they will subsequently audit.
- The internal audit group should have, and be perceived to have, support from the deputy head. The audit mandate should receive wide distribution to demonstrate his visible support. Departmental managers should always be required to respond to internal audit findings on a timely basis.
- All audit activities carried out by or on behalf of the department should be integrated into a single audit group.

12.41 The organizational status of the internal audit group in many departments is unsatisfactory. This results in a loss of independence, and as a consequence, a lack of objectivity. The group often has relatively low importance attached to it in the departmental hierarchy, as illustrated by the ease with which operational units establish audit activities on their own. Audit reports, frequently, do not reach the managers who can take corrective action. Frequently, internal audit groups, as a convenient staffing source, have been involved operationally in departmental functions they audit.

12.42 In the Department of National Revenue - Customs and Excise, the Canada Employment and Immigration Commission, the Department of Communications and the Department of Transport the head of the internal audit group now reports directly to the deputy head and the internal audit group's mandate is well communicated to all senior management. This organizational status, which is relatively recent in these departments, should contribute significantly to improving the impact of the internal audit groups and give them the independence which is essential to the effective discharge of their responsibilities.

12.43 Professional resources. *The internal audit group should be professionally competent and have enough resources to carry out its responsibilities.*

12.44 To achieve this end:

- the internal audit group should be given strong leadership by a thoroughly competent professional and be staffed with auditors technically proficient in the variety of disciplines necessary to carry out comprehensive audits; and
- internal auditors should maintain their technical competence through continuing education.

To achieve and maintain consistently high standards of audit, the Comptroller General should monitor the training and development of departmental auditors and should participate in the appointment of auditors at the senior levels.

12.45 Many audit groups now concentrate on audits of a routine financial nature because they are not staffed with auditors capable of performing value-for-money audits or of reviewing complex computer-based systems. Few departments have training plans to develop their staff, and even where there are such plans, insufficient time is devoted to them.

12.46 Performance of audit work. *Appropriate standards of performance must be defined and followed in each audit assignment.*

12.47 Improvements in the performance of audit work can be expected if:

- standards are followed that address all aspects of comprehensive auditing;
- appropriate audit methods and procedures are established and documented in an audit manual;
- decisions on the nature, extent and timing of audit tests and procedures are based on an evaluation of the systems of internal control operating in the department; and
- audit working papers clearly document the audit process and substantiate findings.

12.48 Many departments have no assurance that audits are properly carried out because performance standards have not been defined. Frequently, there is no evidence that audit work is supervised and audit working papers are reviewed. Established methods and procedures are seldom used for giving guidance to audit staff. Documentation of audit findings is generally poor; some audit reports reviewed during the study did not have any supporting working papers. Audit files frequently lack a proper

indexing system to ensure that all procedures are performed, that information can be retrieved at a later date, and that evidence can be produced if findings are challenged.

12.49 The Comptroller General has provided guidelines for financial audit; these should be extended to cover all aspects of a comprehensive audit.

12.50 Reporting audit findings. *The results of the audit should be documented in a formal report to provide a constructive vehicle for change, be discussed with the managers affected and be presented on a timely basis to the deputy head and his audit committee.*

12.51 Draft audit reports should be discussed with the head of the organization being audited before being finalized and his response should be included in the report.

12.52 Audit reports should be as clear and objective as possible to help management appraise the seriousness of the problems reported. Limitations in the scope of audit should be disclosed. The measurement or evaluation criteria used by the auditor should also be clearly indicated.

12.53 Audit reports should be addressed to the deputy head with a covering letter drawing to his attention issues he should consider. Copies should also be sent to members of the audit committee. The internal audit group should systematically follow up their audit findings and advise the deputy head if adequate action is not taken to resolve matters previously reported. This is of special importance to the establishment and maintenance of effective management control by the deputy head and members of the top management team in departments.

12.54 We noted several deficiencies common to many departments in the reporting of audit findings including:

- Reports were issued long after completion of the audit work, making the information of little value. In these cases the reports could hardly be considered a constructive vehicle for change.
- Problems were not adequately identified and their significance was not clearly stated.
- Restrictions in the scope of the audit were not reported. This could leave management with a false sense of security, possibly believing that the scope of the audit had been much greater than it was.
- Reports were addressed to officials other than the deputy head or an audit committee, leaving it uncertain whether all findings were drawn to the attention of the deputy head. Frequently, the addressee had no authority to effect remedial action.
- Audit findings were not systematically followed up to determine what action has been taken.

12.55 Use of audit committees. *Audit groups should have the leadership and support of an audit committee composed of senior management and suitably qualified persons from outside the department to provide additional objectivity. Preferably, the deputy head or a person of equivalent stature from inside or outside the public service should chair the audit committee.*

12.56 The deputy minister should appoint an audit committee of appropriate senior departmental officials and suitably qualified persons from outside. The committee should provide guidance and support to the audit group by:

- approving audit plans and programs;
- ensuring that all programs and activities of the department are considered when selecting areas for audit;
- discussing audit reports and findings and identifying how findings in one area might relate to other areas;
- seeing that corrective or preventive action is taken on audit findings;
- considering matters raised by the Office of the Auditor General;
- assessing the adequacy of resources for the audit activity; and
- advising on the appointment of the head and members of the internal audit group.

This is of particular importance to ensure adequate recognition throughout the organization of the accountability of every manager for the economical, efficient and effective expenditure of public funds. Periodic attendance at audit committee meetings by the Minister or his direct representative, possibly the Parliamentary Secretary, would be a recommended and highly desirable practice. It would help to emphasize the accountability of managers to government, to Parliament and ultimately to the taxpayer for the effective control and good management of public money.

12.57 Some departments have not yet appointed an audit committee. In some departments that have committees, they are not fulfilling their responsibilities. In other instances, terms of reference for the committees are not well defined.

12.58 The Department of Transport recently revised the terms of reference for its audit committee to include all appropriate responsibilities. In addition to including the Deputy Minister, as chairman, and other senior departmental managers, a senior official from another department has been appointed to the committee. Representatives from the Office of the Comptroller General and the Audit Office have an open invitation to attend monthly meetings. The Department of National Revenue - Customs and Excise also recently appointed an audit committee with a sound mandate.

Management Support and Leadership

12.59 Integrated audit groups and better quality audit practices are essential for effective internal auditing. However, improved organizational arrangements and techniques alone are not enough. Until deputy heads and their senior managers appreciate the benefits to be derived from a properly done comprehensive audit, the value obtained from the substantial effort now devoted to internal audit will continue to be unsatisfactory. Internal audits may be perceived as a threat by poor managers, and that cannot be avoided, but good managers should see internal audit as a means of enhancing their own ability to control performance.

12.60 the departmental level. With a few notable exceptions, senior management has failed to appreciate the potential benefits of internal auditing and has paid little attention to the quality of existing

auditing in their departments. There has been a corresponding lack of support for and direction to the audit activity. As a result departments have been confused about what auditing is, what auditors do and how the function should be organized to achieve the greatest possible benefits. Most departments have intentionally limited their audit activities to financially-based internal audits that are inadequate for today's needs especially having regard to the much greater emphasis that Parliament has placed on value-for-money auditing through the enactment of the Auditor General Act.

12.61 All too frequently the prevailing attitude toward audit is one of resentment rather than appreciation of the contribution auditing can make in ensuring that government programs are carried out, not just with probity, but with due regard for economy, efficiency and effectiveness. These attitudes generate inevitable reactions among auditors themselves about their proper role and the importance of their work. If objective assessment and constructive criticism are resented, there can be little job satisfaction for the auditors. One result is that better auditors leave. A vicious circle results. Changing the views of management about the audit function will not be an easy task; it will require strong central direction from deputy heads as well as the Comptroller General of Canada.

12.62 A few positive steps have been taken to institute changes for the better. A series of briefing sessions in May and June of this year informed deputy ministers of the progress on this year's audits by our Office. The positive reactions to recommendations to integrate and give greater importance to the internal audit function were encouraging.

12.63 By the Treasury Board. To date, central agency support for internal audit has been spasmodic and often divisive. Early in 1978, I met the Secretary of the Treasury Board to discuss the need for co-ordinating audit and evaluation activities both within the Treasury Board and in departments. No immediate action was taken as it was felt that this issue could best be dealt with by the new Comptroller General. Shortly after his appointment and as part of the Treasury Board Secretariat reorganization, the Comptroller General was given responsibility for the existing Financial Administration Branch, including the evaluation of departmental adherence to the Treasury Board policy on financial administration. Also assigned to him was the former division of the Planning Branch responsible for evaluating departmental adherence to the Treasury Board policies on performance measurement and effectiveness evaluation. We also understand that the Comptroller General will be assuming functional responsibility, on behalf of the Secretary of the Treasury Board, for coordinating the evaluation activities of other branches of the Treasury Board Secretariat, including adherence to Treasury Board administrative and personnel policies. Completion of this reorganization and reassignment of responsibilities should establish a sound basis for central direction in carrying out fully integrated comprehensive audits.

12.64 The development of a strong, well organized internal audit function, staffed by competent well-motivated individuals and carrying out a comprehensive audit under good leadership and the overall direction of a properly constituted audit committee is of major importance. It is one of the best ways to ensure that the human, physical and financial resources entrusted to Government by Parliament, and to managers by Government, are being managed with due regard to economy, efficiency and effectiveness. It is also important for ensuring that, through good co-ordination and appropriate reliance upon the internal audit function, the work of our Office is carried out economically, efficiently and effectively. Unfortunately, the findings of our current review preclude us from relying on many internal audit groups at this time. Accordingly, in my future Reports to Parliament, this vital aspect of an effective financial management and control system will be given the closest attention.

1978 Report of the Auditor General of Canada - Chapter 13

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Organization and Activities of the Audit Office</H1>
</CENTER>

<HR>

Introduction

13.1 During the last year, the Audit Office operated for the first time under authority of the new Auditor General Act which was proclaimed as of August 1, 1977. For the reader's convenience, the Act is reproduced in Appendix A of this Report. Section 6 of the Act requires the Auditor General to express an opinion on the several financial statements which are required by Section 55 of the Financial Administration Act to be included in the Public Accounts. Section 7 requires the Auditor General to report to the House of Commons anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including cases where he has observed certain specified deficiencies.

13.2 Section 11 of the Act permits the Auditor General to make specific inquiries whenever the Governor in Council so directs. Under this Section, the Audit Office continued its examination of the Oil Import Compensation Program, referred to in Chapter 22 of the Report.

13.3 The Auditor General is also required to express an opinion on: the accounts of 33 agency and proprietary Crown corporations in accordance with Section 77 of the Financial Administration Act; 57 departmental Crown corporations and other entities, including the accounts of the Governments of the Yukon and Northwest Territories and affiliated organizations; and the accounts of the United Nations and several of its agencies and affiliated organizations.

Office Organization

13.4 Enactment of the new Act has enabled further significant steps to be taken to complete the reorganization of the Office which began some five years ago. These changes have all been made with the intent of establishing a plan of organization comparable to the structure of national public accounting firms. We have been successful in obtaining on full time staff the services of 28 seasoned professionals as of August 1, 1978 to assume responsibilities equivalent to that of a Partner in a professional accounting firm. These officers, known in the Office by the designation Principal, are of key importance as all work in an individual department or agency is channelled through them. The revised plan of organization is shown in Exhibit 13.1.

Exhibit not available

13.5 The general direction of the Office is the responsibility of the Management Committee, comprising the Auditor General and the Deputy and Assistant Auditors General. The Office now consists of six Groups:

- Departmental and Corporate Audits;
- Control Evaluations;

- Professional Services;
- Planning and Reports;
- International Audits; and
- Human Resources and Administration.

13.6 The Departmental and Corporate Audits Group, comprising 22 audit teams and seven regional offices, is responsible for organizing and conducting legislative and financial audits in government departments, agencies and Crown corporations. In addition to such annual reviews, the Group's objective is to carry out cyclical comprehensive audits at least once every four years in every department, agency and Crown corporation audited by this Office. As described in Chapter 11 of this Report, such comprehensive audits encompass all of the techniques that have been applied during the Financial Management and Control Study, the Computer and Information Systems Evaluation Study and the Study of Procedures in Cost Effectiveness. They are designed to provide Parliament at least once every four years with an in-depth evaluation report on each government entity for which the Office has audit responsibility.

13.7 The Control Evaluations Group involves three main programs which are being incorporated progressively in the cyclical comprehensive audit approach. Financial Management and Control Studies conducts studies in government departments, agencies and Crown corporations to evaluate and report on the state of financial management and control procedures, and other matters affecting the quality of financial management. Special Audits and Inquiries conducts audits and inquiries relating to specific subject areas of government financial administration or to broad general topics on issues that have government-wide impact. Projects may be initiated by the Office or requested by the Government under authority of Section 11 of the Auditor General Act. The Study of Procedures in Cost Effectiveness was organized within this Group.

13.8 The Professional Services Group encompasses a number of diverse supportive and advisory professional activities within the Office. Computer Audit Services is concerned with reviewing the Government's computer-based financial systems, developing EDP audit technology, implementing computer-assisted audit techniques and training audit staff. Professional Practices is responsible for developing and maintaining modern auditing standards and procedures, conducting research in accounting and auditing, providing a consultative, advisory service to staff and developing and maintaining the audit manuals and guides of the Office. An integral part of the Group is Professional Development which has responsibility for the training and development of professional personnel.

13.9 The Planning and Reports Group includes Public Accounts Audits which has responsibility for co-ordinating the Office's examination of the accounts and financial statements of Canada and recommends to the Auditor General the nature of the opinion he should provide on the main financial statements included in the Public Accounts. It also advises the Auditor General on principles and practices of accounting appropriate to the accounts and financial statements of Canada and on changes in such principles and practices proposed from time to time by the Government. Program Planning is responsible for co-ordinating both the development of the Office's audit plans and the assignment of professional staff to the various audit groups within the Office. Reports and Communications has co-ordinating responsibility for the preparation of our annual Report to the House of Commons and for liaison with the Standing Committee on Public Accounts, Members of Parliament and central agencies of the Government.

13.10 The International Audits Group acts for the Auditor General who, as one of the three members of the United Nations Board of Auditors, is responsible for the audit of the United Nations and some of the specialized agencies.

13.11 The Human Resources and Administration Group is responsible for all personnel administration, contract administration and financial and administration services to the Office.

13.12 Three independent advisory committees provide guidance to the Office on complex problems and important issues that arise regularly in carrying out our work. The Independent Advisory Committee on Government Accounting and Auditing Standards comprises five chartered accountants who are recognized authorities on accounting and auditing principles and practices in Canada. The Independent Advisory Committee on Financial Management and Control Standards consists of five partners of firms, all of whom were intimately involved in the Financial Management and Control Study. The most recently established committee, the Independent Advisory Committee on Computer Audit Standards, consists of five partners of firms all of whom were members of the Steering Committee of the recently terminated Computer and Information Systems Evaluation Study.

Assistance to the Standing Committee on Public Accounts

13.13 The Audit Office has continued to give high priority to providing assistance when desired by the Standing Committee on Public Accounts in its review of the annual Report. The Office was represented at all meetings of the Committee by either the Auditor General or a Deputy Auditor General and by other senior officers as appropriate to the matter under review. We assisted the Sub-committee on Agenda and Procedures in planning the Committee's review of our 1977 Report.

13.14 During the last year the principal subjects considered by the Public Accounts Committee were Atomic Energy of Canada Limited, our 1977 findings and recommendations of the Computer and Information Systems Evaluation Study, our 1976 and 1977 studies on the financial management and control practices of Crown corporations, our 1976 and 1977 findings and recommendations on a number of special audits and inquiries and Bill C-10, an Act concerning the creation of the position of Comptroller General. Recommendations of the Committee were included in its three Reports to the House of Commons which are reproduced in Appendix E.

Study of Procedures in Cost Effectiveness (SPICE)

13.15 Last year we reported that the Office, in preparation for the introduction of the new Auditor General Act, was undertaking a government-wide Study of Procedures in Cost Effectiveness (SPICE), a major project to assess the adequacy of management controls in the Government in terms of value for money. As described in Chapter 2 of this Report, the Study had been examining selected programs within certain departments and agencies of the Government, gathering information and knowledge, developing expertise and identifying the talents and resources required by the Audit Office for the fulfilment of its new mandate. With proclamation of the Auditor General Act as of August 1, 1977, the SPICE project was transformed from a research effort into an expanded operational program. This year the first results of our studies based on the value-for-money concept are being communicated to the House.

13.16 SPICE teams have raised questions about the attention that management is giving to questions of economy, efficiency and effectiveness. As a result of the first departmental examinations, several general areas of management control were identified. Three of these areas have been investigated in some detail and the significant issues that have been identified are reported in Chapters 3 to 5 of this

Report. Investigations of other management areas are proceeding. As further significant issues emerge from this work, they will be included in future annual Reports.

Computer and Information Systems Evaluation (CAISE) Study

13.17 The Computer and Information Systems Evaluation (CAISE) Study was completed in December 1977 shortly after being presented in our 1977 Report. The Audit Office is, however, developing a permanent EDP audit capability as part of the Professional Services Group. A Principal, Computer Audit Services, has been appointed and he is being assisted by the Independent Advisory Committee on Computer Audit Standards described in paragraph 13.12. Those persons who took part in the Study continue, on a reduced scale, to give needed support to the development of this "in-house" computer capability. The results of our monitoring of government actions on the CAISE recommendations reported last year are included in Chapter 10 of this Report.

Financial Management and Control Study

13.18 As reported in the 1977 Report, the Financial Management and Control Study (FMCS), initiated in May 1974, was completed in 1976-77. During the last year, the Office continued to monitor corrective actions taken or planned by departments, agencies, Crown corporations and the two territorial governments in response to the Study's recommendations. Particular emphasis was placed on departmental financial organizations and in Chapter 8 we report on action taken concerning our 1976 recommendation that a Comptroller be appointed in each department, agency or Crown corporation. The issues raised by the FMCS and by our related monitoring activities, are now integrated into the expanded scope of our audits.

Special Audits and Inquiries

13.19 During 1977-78, five special government-wide studies were carried out. The results of four of these studies are included in this Report:

- Improving Financial Information for Parliament (Chapter 6);
- Charging for Accommodation Services (Chapter 7);
- Contracting Procedures (Chapter 9); and
- Comprehensive Internal Auditing Within Government (Chapter 12).

The fifth, a study of telecommunications services in nine government departments, is still under way. This study will be completed during the current year and matters which should be drawn to the attention of the House of Commons will be included in my 1979 Report.

13.20 During the coming year, a study will be initiated on Excise Revenue Systems of the Department of National Revenue - Customs and Excise and it is expected that the results will be reported in 1979.

Audit Operations

13.21 Appendix C of this Report contains the Auditor General's certificates on the main financial statements of Canada and our observations on these statements which also appear in Volume 1 of the Public Accounts.

13.22 Chapters 14 to 19 of this Report include the findings, observations and recommendations arising from six exploratory comprehensive departmental audits carried out during the past year.

13.23 Chapter 20 includes comments on the financial statements and operations of the Crown corporations and other entities for which the Auditor General is required to express separate opinions. It contains a list of all such corporations and entities.

13.24 Chapter 21 contains observations reported under Section 7 of the Auditor General Act on irregularities disclosed during Audit Office examinations and on other matters the Auditor General considers should be brought to the notice of the House of Commons.

13.25 Finally, Chapter 22 comments on specific matters dealt with in previous Reports of sufficient significance to be reported to the House of Commons again. These comments arise from the Office's continuous follow up and monitoring of actions taken to correct deficiencies previously reported.

International Audits

13.26 The Auditor General of Canada has continued to be involved with international audits in keeping with expectations resulting from Canada's participation in international organizations. This not only represents a part of Canada's continuing involvement with the international community, but has also provided an excellent opportunity for the staff of the Office to broaden their experience and enhance their professional development.

13.27 The Board of Auditors of the United Nations consists of the Auditors General of Bangladesh, Canada and Ghana. Canada's three-year term expires on June 30, 1980. As noted in previous Reports, the Board of Auditors has introduced significant organizational and procedural changes to give greater substance to the concept of joint and several responsibilities under which the Board operates, and to shift the emphasis from transaction-based auditing to systems-based auditing. In its report to the United Nations General Assembly for the 1976-77 biennium, the Board of Auditors highlighted the results of the financial management and control study, giving emphasis to the observations and recommendations resulting from the shift to systems-based auditing. This report also commented on the progress achieved in integrating the audit approach, made possible largely through the establishment of the Audit Operations Committee in June 1976. Edward R. Rowe, an Assistant Auditor General who was the first Chairman of the Audit Operations Committee, and Michael R. Harle, the Director of External Audit (Canada) and a Principal in our Office under the Executive Interchange Program, completed two-year assignments with the Board of Auditors in June 1978. They have been succeeded by G. Peter Wilson, an Assistant Auditor General, and Bonnie P. Miller, a Principal in the Office.

13.28 In addition to reporting to the General Assembly on the United Nations itself, the Board of Auditors also issued 10 reports on other significant elements of the United Nations Organization. The Canadian staff has had prime responsibility for the audits of the United Nations itself, including its peacekeeping operations and special trust funds, as well as the UN University, the UN Institute for Training and Research and the UN Joint Staff Pension Fund.

13.29 The Auditor General of Canada is also the external auditor for the International Civil Aviation Organization, a specialized agency of the United Nations, the only such agency located in Canada. A special report was completed in June 1978 containing highlights of a review of this agency's system of financial management and control. The review was carried out by the staff of our Montreal Regional Office under the general direction of Mr. Rowe.

13.30 In June 1978, Canada completed a three-year term on the North Atlantic Treaty Organization's Board of External Auditors. Based in Brussels, Frederic Belanger, an Audit Director, represented Canada on the Board for some 18 months succeeding the late Alexander G. Cross, a former Director General of the Office. During this time, considerable progress was achieved in developing audit programs and procedures and permanent audit files to facilitate the mandatory rotational feature of the NATO audit arrangements.

13.31 Along with Tunisia and Panama, Canada provided a member for the 1978 External Audit Committee for the International Monetary Fund. Harold E. Hayes, a Principal in our Office, served as Canada's member on the Committee at the Fund's Headquarters in Washington, D.C., in May and June.

Human Resources

13.32 The Audit Office is continuing its efforts to establish a career pattern for staff similar to that found in major public accounting firms. We believe that service with the Office can provide excellent training for promising young professionals. Our recruitment and training programs are planned accordingly. Twenty-six university graduates joined the Office in 1978 and all are enrolled in professional training programs leading to qualifications of CA, CGA or RIA. Our personnel policies are based on the premise that movements of people into and out of the Office serve both to prevent a hardening of intellectual arteries within the Office and to provide a source of competent individuals for financial and management positions at all levels in the public service.

13.33 At August 1, 1978, 201 of our full-time professional staff members were qualified for membership in professional accounting associations and 12 had other professional qualifications. One hundred and fourteen students-in-accounts were enrolled in programs leading to professional accounting designations.

13.34 The following table presents a profile of full-time staff at August 1, 1978, March 31, 1978, and March 31, 1977, excluding those recruited under the Executive Interchange Program:

	August 1 <u>1978</u>	March 31 <u>1978</u>	March 31 <u>1977</u>
Senior management	28	24	17
Directors and managers	67	67	54
Supervisors and auditors	139	136	139
Other audit staff	<u>112</u>	<u>91</u>	<u>91</u>
Professional staff	346	318	301
Support and administrative staff	<u>147</u>	<u>140</u>	<u>110</u>
	<u>493</u>	<u>458</u>	<u>411</u>
In the National Capital Region	384	360	316
In other parts of Canada	<u>109</u>	<u>98</u>	<u>95</u>
	<u>493</u>	<u>458</u>	<u>451</u>

13.35 The Office continues to make extensive use of professional resources available from the private sector, not only to supplement the work of the permanent staff but also to provide a variety of specialized knowledge and experience not required on a full-time basis. Thus we are able to enrich the experience of the permanent staff and also to achieve increasingly higher auditing standards. At August 1, 1978 there were 22 individuals associated with the Office under the Public Service Commission's

Executive Interchange Program and 183 persons on professional service contracts for varying periods of time.

13.36 Members of the Audit Office who retired during the year include: J. Marcel Laroche, RIA, LLB, an Audit Director with over 34 years service; Kenneth J.G. Young, RIA, an Audit Manager with over 37 years service; Helen J. Scott, a Clerk with over 35 years service; Donald H. McMillan, CGA, an Audit Manager, and M. Marguerite Gratton, Secretary to a Deputy Auditor General, each with over 32 years service; Beatrice G. Bottema, a Secretary in our Edmonton office, and Ruby L. Mick, a Secretary in our Toronto office, each with over 30 years service; and Ronald C. Collins, a Senior Auditor, with over 21 years service. Each has made a contribution to the effectiveness and spirit of the Office which is deeply appreciated.

Official Languages

13.37 Changes in the Official Languages Program, which have been in effect since October 1977, have resulted in broader responsibilities for departments and agencies. In the spirit of the Government's reaffirmed commitment to the objectives of the Official Languages Act, R.S., c. 0-2, and the Resolution adopted by Parliament, the Office has undertaken a systematic review of the language requirements of positions. As a result, 318 positions have been re-identified, 143 employees have taken the Language Knowledge Examination and 22 have been sent on language training. Work is nearly completed on an in-house language training plan.

Professional Practices

13.38 During the year all professional staff received a final version of the audit manual referred to in last year's Report. A program is now under way to update and amend the audit manual to include all aspects of the comprehensive audit referred to previously and thus provide uniform standards and practices for all audit activities of the Office. The Audit Office also established internal Accounting and Auditing Standards Committees to assume certain responsibilities of the existing Independent Advisory Committee on Government Accounting and Auditing Standards.

Legislative Auditors' Conference

13.39 The Canadian Legislative Auditors held their sixth annual conference in Edmonton, September 25-27, 1978, and exchanged views on technical and other matters of common interest. Some 40 senior members of the federal and provincial audit offices attended. The agenda included such timely subjects as: financial auditing as a prelude to program evaluation; a report by each of the legislative auditors on the current status of legislation affecting their offices; the role of Public Accounts Committees and their relationship with the legislative auditor; computer auditing; a report on the Canadian Institute of Chartered Accountants' Study Group on Financial Reporting Practices by Governments; and developments in staff training programs. Guest speakers included the Hon. Peter Lougheed, Premier of Alberta; Dr. Mort Dittenhoffer, Executive Vice President, Association of Government Accountants; Mr. John D. Heller, Assistant to the Comptroller General, U.S. General Accounting Office; Mr. Ruben J. Rosen, Partner, Touche Ross & Co.; Mr. Kenneth J. Sharp, Head of the Government Accountancy Service, Great Britain; and Mr. Patrick Reid, M.P.P., Chairman of the Ontario Standing Committee on Public Accounts.

New Office Accommodation

13.40 During the last year, the Audit Office moved to new accommodation in the C.D. Howe Building, 240 Sparks Street, Ottawa. This relocation to more modern and attractive surroundings has enabled the Office to house its employees in one location and has provided a better professional working environment. Some other notable benefits of the new facilities are more effective internal communications and increased security over Office operations.

Audit Office Expenditures

13.41 Exhibit 13.2 presents Audit Office Estimates and Expenditures by Activity and by Object.

Exhibit not available

1978 Report of the Auditor General of Canada - Chapter 14

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Canada Employment and Immigration Commission Summary of Findings, Observations and Recommendations</H1>

</CENTER>

<HR>

Introduction

The Commission

14.1 In August of 1977, legislation was adopted merging the Unemployment Insurance Commission and the Department of Manpower and Immigration into the Canada Employment and Immigration Commission. The merger was accomplished through the Employment and Immigration Reorganization Act, 1976-77, c. 54, which also formed the Department of Employment and Immigration. The latter provides planning and research services to the Commission.

14.2 As a result of the integration, the Canada Employment and Immigration Commission becomes one of the largest and most complex organizations in the government, with annual expenditures in excess of \$5,000 million and authorized man-years of approximately 25,000. In terms of gross expenditures, the Commission is only surpassed by National Health and Welfare, and Finance. In terms of authorized man-years, the Commission is the fifth largest departmental organization.

14.3 The Commission is organized into three distinct groups: (1) Labour Market Policy; (2) Immigration and Demographic Policy; and (3) Benefit Programs. These groups are in turn organized into 10 regions, following provincial boundaries, and a Foreign Service Branch. The result is a very decentralized organization with over 500 points of service across the country. Another characteristic, which adds to the Commission's complexity, is the variety of programs it operates to accomplish its objectives.

14.4 The Labour Market Policy group's objectives comprise the development and use of manpower resources in Canada and the provision of employment services. It meets these objectives by operating more than 20 different programs, generally of three types; job creation, such as the Canada Works program; training, such as the Canada Manpower Training program; and labour market development, such as the Summer Job Corps program. More than 300 Canada Manpower Centres provide employment services and also assist in administering programs.

14.5 The Immigration and Demographic Policy group deals with the admission of immigrants and non-immigrants in accordance with the economic, social and cultural interests of Canada. This objective is accomplished by funding four immigrant assistance programs and by operating over 150 Immigration Centres throughout the country and abroad.

14.6 The Benefit Programs group aims at providing short-term financial relief and other assistance to eligible workers. It meets this objective by operating more than 300 district Unemployment Insurance offices which initiate benefit payments to claimants.

14.7 Exhibit 14.1 outlines the organization chart of the Commission and Department. The following table summarizes their financial operations for the 1977-78 fiscal year.

Exhibit not available

Summary of Financial Operations
(in millions of dollars)

Canada Employment and Immigration Commission

Labour Market Policy and Immigration
and Demographic Policy groups:

Administrative costs		\$	40
Labour Market Policy group -			
Operations	\$	222	
Training programs		572	
Job creation programs		321	
Labour market development			
programs		<u>25</u>	1,140
Immigration and Demographic Policy group -			
Operations	\$	64	
Programs		<u>4</u>	<u>68</u>
Benefit Programs group:			1,248
Revenues			
Premiums	\$ 2,551		
Government's share			
of costs	<u>1,739</u>		
Total revenues	<u>\$ 4,290</u>		
Benefits paid out	\$ 3,904		
Administrative costs	<u>234</u>		4,138
<u>Department of Employment and Immigration</u>			
Planning and research costs			<u>9</u>
			<u>\$ 5,395</u>

Summary of Audit Office Activities

14.8 In planning its audit of the Canada Employment and Immigration Commission, the Office of the Auditor General adopted as comprehensive an approach as possible, one which cuts across all of the major programs and responsibility centres of the Commission. It incorporates the regular audit work of the Office as well as any special project which it may undertake from time to time, and enables the Auditor General to present a comprehensive report on the activities of the Commission.

14.9 Because of the Commission's size and complexity, it is not possible in any one period to review all functions or activities or both. The selection of the areas which have been covered in the current year was based on the Office's knowledge of the Commission and tended to focus on those programs and activities where our findings were likely to have the greatest significance, given the nature of the programs and the difficulties of the Commission in administering them. Although the work carried out to date has covered all major programs and is sufficient for the Office to present a comprehensive report, it does not contain observations on certain areas which will be dealt with in

future years. These include the Estimates process and financial reporting, which were omitted because of the particular impact on these functions of the recent merger referred to previously.

14.10 The 1977-78 audit of the Commission was divided into five phases:

1. A review of the organization and the role of the financial function in the Commission.
2. Studies of procedures in cost effectiveness for:
 - the Canada Manpower Training Program;
 - the Local Initiatives Program; and
 - departmental Performance Measurement Systems.
3. A review of internal audit activities within the Commission.
4. A review of the Benefit Programs group which included:
 - an examination of the Benefit and Overpayment System (including a statistical sample of benefit payments);
 - a follow-up on the 1977 Computer and Information Systems Evaluation Study;
 - a review of the development of the On-line Benefit Pay System; and
 - an examination of the financial accounts.
5. An examination of the accounts of the Labour Market Policy and the Immigration and Demographic Policy groups, which included a review of the financial control systems and tests of transactions in all major programs and activities in all regions.

14.11 At the conclusion of each phase of the audit, this Office issued to the Commission a report or management letter outlining our findings. This Chapter is a summary of the more significant of these findings.

14.12 We would like to take this opportunity to express our thanks to the Commission's personnel who provided excellent co-operation throughout our audit, particularly in view of the fact that the Commission was undergoing a significant period of change due to the merger.

Distinctive Features of the Commission

14.13 Based on the audit work performed and because of the approach employed, certain characteristics of the Commission became apparent which need to be considered when reviewing the individual findings. The two most important are:

- the organization of the Commission follows a decentralized structure, where most of the responsibility for program delivery rests with the regions and program and functional managers enjoy relative autonomy from each other; and

- a significant portion of the Commission's activities concern payment of funds under programs of economic support and relief, where the Commission has to monitor constantly the recipients' eligibility to receive such payments.

14.14 The element, of decentralization and autonomy reflected in the Commission's organization structure can be attributed to its size and to the complexity and diversity of its programs. Excessive decentralization and autonomy in any organization, however, can lead to problems in establishing effective control over decentralized activities and in ensuring the uniform interpretation and application of departmental policies. This, in turn, makes it more difficult to ensure that activities are being carried out in an economic, efficient and effective manner. Striking the right balance between decentralization and autonomy and the need for centralized controls is not an easy process. It is particularly difficult in the case of the Commission because of the sensitive nature of the programs it administers.

14.15 We have not reviewed all activities in the Commission, nor have we reviewed the organizational structure in detail. Thus, we are not in a position to comment fully on the new plan of organization. Nevertheless, we observed a few situations where the degree of decentralization may have caused certain problems in program administration.

14.16 For example, we noted instances of variations in the interpretation of the Unemployment Insurance Act, 1971, 1970-71-72, c. 48, between local offices (paragraph 14.130), some inconsistency between the insurance objective of the Unemployment Insurance program and the objectives of certain job creation programs (paragraph 14.123), and a lack of co-ordination between various evaluation and audit activities (paragraph 14.86).

14.17 These observations do not by themselves constitute evidence that the Commission's decentralized and autonomous approach is inappropriate. In fact, similar problems can be found in most organizations of this size. However, this characteristic should be taken into account in assessing the present situation and in deciding on any further decentralization.

14.18 The Commission spends over \$5,000 million in contribution programs, almost all of an economic support nature. This makes the Commission one of the largest "distributors" of government funds and adds to the difficulty of administering its activities, since it has to constantly concern itself with maintaining an appropriate balance between prompt service and humanitarian considerations and continuous control over eligibility and validity. This characteristic can be found in programs such as Unemployment Insurance, Canada Manpower Training, Canada Works and Young Canada Works. It makes such programs difficult to administer in an appropriate control environment, since the Commission is under constant pressure to deliver them as rapidly as possible so their impact will be felt almost immediately.

14.19 The recent merger of the Department and the Commission was brought about principally by a desire to co-ordinate related programs better and thus alleviate the effects of decentralization. This benefit could also be achieved in other areas or functions in the Commission through better co-ordination of individual programs or stronger central direction or both. In this respect, the Commission has made a number of notable efforts, coinciding with the merger. In the near future, these should improve financial administration and the monitoring of program efficiency and effectiveness.

14.20 A sound financial organization structure constitutes one of the most important elements of an effective financial management and control system. Consequently, the Office of the Auditor General has been emphasizing this area and we included in the audit of the Canada Employment and

Immigration Commission an assessment of the new plan of organization for the financial function now being implemented.

14.21 Exhibit 14.2 portrays the organization of the financial function and the administrative services. A basic principle embodied in this chart and in the Commission's plan is that through his subordinates the Executive Director, Finance and Administration, is responsible for giving functional guidance to financial officers in each of the 10 regions and to senior program officers at Headquarters. The organization structure has been designed to meet the Treasury Board's criteria for organizing the financial function.

Exhibit not available

14.22 Since certain of the proposed organizational arrangements are still being finalized, and organizational relationships and divisions of responsibility still being sorted out, it would be premature at this stage to evaluate how well the new plan is working. Instead, we concentrated on assessing the extent to which it meets criteria normally used in this type of assessment.

14.23 Among the more important of the criteria are:

- the degree of involvement of senior financial personnel in the departmental decision-making process;
- the appropriateness of the role of senior financial personnel in advising and assisting senior program personnel on all aspects of the financial management and control function, including the preparation of Program Forecasts and Estimates;
- the extent to which senior program personnel understand their financial management responsibilities and the adequacy of the methods for familiarizing new personnel with their responsibilities in this area;
- the acceptance by both senior financial and program personnel of the senior financial officer's mandate for ensuring that adequate financial controls exist within all financial systems, including those that are not his direct responsibility;
- the adequacy of staffing arrangement, for financial positions, including the selection, training and evaluation of financial personnel; and
- the adequacy of the functional guidance given by senior financial officers to financial personnel outside their respective jurisdictions and the mechanisms that exist for this purpose.

14.24 In making this assessment, we reviewed the organizational arrangements set out in the pamphlet entitled "Organizational Proposal - Finance" dated April 1977 and the job descriptions prepared for certain key financial positions. We also interviewed a number of key people at the National Headquarters and in the regions, including financial officers and program directors.

14.25 In general, the organizational arrangements intended by the proposed plan of organization indicate a high degree of awareness of the way in which the financial function in a large-scale government department should be organized and carried out. In our opinion, this arrangement will work quite effectively as long as the spirit of co-operation that appears to exist between senior program and senior financial personnel continues, and as long as the position of Executive Director, Finance and

Administration, continues to be filled by someone with extensive experience who has a thorough knowledge of financial management principles and practices in the Federal Government.

14.26 We do not feel that it would be appropriate for our Office to make specific recommendations now on this area of the Commission's administration. Instead, we plan to follow up on the implementation of the proposed plan in future audits. However, there are certain observations we feel we can make and which the Commission may wish to take into account in implementing its new plan. For example, senior program personnel who may have a high degree of technical knowledge and ability but limited exposure to Federal Government financial management practices may be appointed to program management positions. Every effort should be made to ensure that they are properly indoctrinated into these and other management practices. We doubt that adequate provision exists for this now.

14.27 Similarly, a major difficulty facing the senior financial personnel in the Commission will be to convince program heads who previously had financial advisers reporting directly to them that they can be served more effectively and more efficiently by a group of financial advisers forming part of the central financial services function. However, everyone we discussed this question with appeared satisfied that the proposed arrangement is workable and that the organizational arrangements now being implemented represent an improvement over those in the former Department of Manpower and Immigration.

14.28 Thus, once the Commission has an opportunity to firm up its financial organizational arrangements, we believe there is every likelihood that the proposed plan of organization will function effectively.

Studies of Procedures in Cost Effectiveness

Background

14.29 Studies of Procedures in Cost Effectiveness (SPICE) represent a new audit approach employed for the first time in 1977-78. The studies were designed to determine whether funds are expended with due regard for economy and efficiency and whether satisfactory procedures have been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented. For the Commission, the studies focused primarily on the procedures to measure and report effectiveness of programs and on performance measurement.

14.30 Strategic Policy and Planning has taken important initiatives in the area of effectiveness evaluation of the Labour Market Policy program. In reviewing the evolution of the Commission's efforts, by examining the Canada Manpower Training Program and the Local Initiatives Program, we observed that significant progress has taken place in the basic approach and in the methodologies used. Although there is still considerable room for improvement, the Commission has demonstrated an awareness of the need for upgrading the quality of its evaluations and a desire to do so.

14.31 The Benefit Programs group was one of the first to implement performance measurement systems within the Canadian Government. Performance measures have since been developed for many of the programs and resources used within the Commission, although the assessment of performance has not progressed at an equal rate in all groups.

Canada Manpower Training Program

14.32 The Canada Manpower Training Program operates under the Adult Occupational Training Act, R.S., c. A-2. The Act states that the objectives of the Program are to:

- increase the earning capacity of adults; and
- increase their opportunities for employment.

To meet these objectives, the Federal Government purchases institutional classroom training, involving both basic courses and courses in various skill areas, and selects and refers applicants for training. The Government also encourages industry to conduct its own on-the-job training by partially subsidizing wages paid to employees undergoing industrial training. The cost of the Program, including contributions and capital expenditures for both institutional and industrial training, reached \$550 million in 1976-77 and was estimated at \$590 million for 1977-78.

14.33 The British North America Act gives the provinces responsibility for education and vocational training. Therefore provincial colleges, schools and technical institutions provide almost all the classroom portion of manpower training. Consequently, although the Federal Government purchases the courses, decisions on the type of training are also of concern to the provinces. A joint Federal-Provincial Manpower Needs Committee makes final decisions on the number, type and Cost of courses to be offered for training and these are evidenced in federal-provincial agreements.

14.34 Allocation of training budget among provinces. In the past, the allocation of the manpower training budget among the provinces has been related more to regional unemployment than to the stated goal of increasing opportunities for employment by providing skills needed for the economy. Consequently, the regional distribution of training dollars has not been as consistent with meeting program objectives as it might have been. The Commission has recognized this problem and has taken measures designed to improve the efficiency of the allocation.

14.35 The Commission should continue its efforts to rationalize the allocation of funds to provinces and should explore means of redressing more rapidly the regional imbalance between training purchases and training needs, in line with the stated goals of the program.

14.36 Cost of courses purchased. The Federal Government has a clear responsibility to enter into negotiations on course prices and provincial overhead costs to ensure that value is received for training money expended. However, meaningful negotiation seldom occurs, primarily because the regional Canada Manpower offices do not perceive themselves as having a strong mandate to negotiate. Program officials indicate that a lack of adequate cost information and insufficient expertise are additional problems that limit effective negotiations. The Commission is attempting to include a provision for more complete cost information in future agreements with the provinces.

14.37 The Commission should strengthen its negotiation of course prices and provincial overhead. To facilitate this, action should be taken to ensure better pricing information. Financial expertise should be strengthened where necessary to offer a better negotiating capability.

14.38 Evaluation of training. In 1977, the Canada Employment and Immigration Commission conducted a major review of the Canada Manpower Training Program jointly with the Treasury Board Secretariat and the Department of Finance. The review provided useful analysis of many issues within manpower training, including a reassessment of the Program's goals. It determined the extent to which each goal was precise and realistic. As a result, program management discarded vague goals adopted

over the years and reoriented the Program toward the goals set out in the Adult Occupational Training Act, namely, to increase earnings and improve employability.

14.39 The Commission conducted effectiveness evaluations on the extent to which the Canada Manpower Training Program increased employability and earnings. These studies lacked the necessary checks to ensure the reliability and validity of the findings. National follow-up studies, for example, were not adequately tested for reliability of the questionnaires or accuracy of the responses. Field follow-up studies were incomplete because they lacked the information necessary to assess and account for the impact of training. Departmental publications referred to benefit-cost analysis results as a prime indicator of the value of the Program, but the 1977 joint study identified numerous methodological weaknesses in the analysis, making the validity of the results questionable. The Commission has decided to reduce its reliance on benefit-cost studies in determining the worth of this Program.

14.40 The Commission had not evaluated the effectiveness of its industrial training program since 1974. An evaluation conducted then relied on two surveys of trainees, each marked by an extremely low response rate, 25% in one and 13% in the other. Such low response rates preclude reliable inferences about program effectiveness.

14.41 The Commission had not carried out systematic research on the effects of providing income support training allowances to all institutional trainees. Thus it did not know whether people undertook training just to obtain the allowance or to what extent the allowance was vital to permit some people to take training. In 1977 the cost of the allowances was over \$200 million.

14.42 Counsellors play a key role in referring candidates to training courses. The Commission had undertaken little research to assess the referral process so it could develop improved guidelines for assessing the potential of applicants. Finally, the Commission had not checked whether its course purchases from individual provinces were consistent with projections of occupational needs within those provinces.

14.43 *The Commission should make every effort to improve the technical quality of its evaluations, adding lines of investigation that could assist in explaining the measured impact of training, and in providing better interpretations and qualifications of reported results. The Commission should also initiate evaluations of the impact of training allowances, the candidate selection process and the course purchasing procedures.*

Local Initiatives Program

14.44 Until its end in 1977, the Local Initiatives Program (LIP) was one of several job creation programs sponsored by the Canada Employment and Immigration Commission. After it was officially discontinued, many of its features were carried forward in the Canada Works Program.

14.45 LIP funds were disbursed during periods of high unemployment to individuals, Organizations and municipalities which submitted proposals expected to meet the Program's two objectives: (1) job creation and (2) community betterment. In all, the cost of the Program was close to \$1,000 million over six years.

14.46 Decision to evaluate. The Commission directed considerable effort to evaluating the extent to which LIP was achieving its goals. Evaluation of accomplishments in terms of the job creation objective was generally satisfactory. A major portion of these evaluation efforts was directed to the evaluation of

the goal of "community betterment" which was never clearly defined. As a result, the Commission funded effectiveness evaluation studies attempting to measure not only community attitudes and perceptions but also the effect of LIP in reducing a wide range of social problems such as crime, alcoholism and child abuse. The likelihood that LIP could reduce such problems was low to begin with, given the limited scale of the LIP projects. However, such studies could be justified as exploratory surveys as long as they did not attempt to draw conclusions on the effectiveness of the program.

14.47 Before undertaking an effectiveness evaluation, the Commission should explore the extent to which program goals can be expressed in measurable terms. The Commission should then determine the reasonableness of attempting to measure the effectiveness of the program.

14.48 Planning and monitoring evaluations. The terms of reference of the effectiveness evaluation studies were overly ambitious in relation to the funds provided and unrealistic compared to the results that the studies could reasonably be expected to produce.

14.49 Technical shortcomings in the evaluation studies seriously affected the reliability of some of the results. For example, a survey designed to determine whether LIP had increased earned income among participants did not include a sufficient number of interviews to detect reliably whether the predicted effect had been achieved. Further, some of the survey questions were poorly worded and could have resulted in ambiguous answers.

14.50 The Commission should ensure that appropriate terms of reference are developed for evaluation studies. In addition, it should improve the planning and conduct of the studies by satisfying itself as to the adequacy of the research design and by monitoring more closely the technical aspects of the studies.

14.51 Reporting procedures. The Commission had no formal procedures to identify, evaluate and document weaknesses and limitations about the LIP evaluation work. For example, unqualified statements on the effectiveness of LIP were reported in official documentation and were used as a basis for subsequent evaluations.

14.52 The Commission should critically examine evaluation reports to identify the strengths, weaknesses and limitations of their methodology and data. The examination would confirm or qualify the conclusions of the evaluation reports and form an integral part of them.

14.53 Support for operating budget. The Commission did not systematically assess the most appropriate ratio of administrative cost to total LIP funding when preparing operating cost budgets and how this ratio might be expected to change as a result of variations in program funding levels and in project type and size. Although standards were used to develop total administrative costs, there was no evidence to indicate how these standards had been developed or what conditions would necessitate their modification.

14.54 The Commission should develop information to ensure that in determining the most effective allocation of departmental resources it gives due regard to the impact of changes in project funding, levels of service, and size and types of projects.

Departmental Performance Measurement Systems

14.55 In the Commission, performance measurement is intended to give management regular information on the performance of its various Operating units and to support Program Forecasts and

Budgetary Submissions to the Treasury Board. Approximately 70% of the labour resources of the Commission are covered by performance measurement systems.

14.56 We examined the performance measurement systems in the Benefit Programs, Labour Market Policy and Immigration and Demographic Policy groups of the Commission. Our examination included an assessment of the actual efficiency of labour in certain parts of the organization including the Central Index (issue and control of social insurance numbers) and a review of the efforts to improve efficiency.

14.57 General assessment. We found that performance measures have been developed for many of the programs and resources, but the assessment of performance has progressed further in some sectors than in others. More specifically, we found that:

- Unit costs are used only in the Benefit Programs group and are well integrated with the financial systems. A higher priority should be given to developing meaningful unit costs as a basic performance indicator for other groups.
- There is a lack of uniformity and coordination in the performance measurement systems used by the different regions and National Headquarters. The time standards, activity definitions and performance indicators vary from region to region. As a result, one cannot readily assess and compare performance between regions and significant opportunities for national improvement go undetected.
- In locations where efficiency was measured in the Benefit Programs group, the level of efficiency appeared to be approximately 65% using the national work standards. In the other two groups, actual efficiency could not be determined using the existing systems.
- The Commission has not developed a coordinated efficiency improvement program to date. To do so, substantial improvements in the development of work standards and the measurement of actual efficiency levels are required in the Labour Market Policy and Immigration and Demographic Policy groups. Where this type of information is already available, such as in the Benefit Programs group, improvements and refinements in its application are required to improve efficiency levels and obtain cost reductions.

14.58 More detailed observations and recommendations relating to the Commission's performance measurement systems are contained in the following paragraphs.

14.59 Benefit Programs. In 1976-77 the Benefit Programs group, formerly known as the Unemployment Insurance Commission, employed more than 10,000 people in providing short-term financial relief and other assistance to workers eligible under the Unemployment Insurance Act, 1971, 1970-71-72, c. 48. These services are provided through more than 300 district offices across Canada.

14.60 The performance measurement system of the Benefit Programs group, which has been refined over the last 10 years, is by far the most advanced and complete within the Commission and one of the most advanced systems within the Canadian Government. This system contains all the essential elements needed for effective performance measurement and has a number of key "operational effectiveness" indicators that enable management to assess the quality and level of service provided. It uses unit costs for assessing overall performance and is able to calculate efficiency at a detailed level using work measurement standards.

14.61 We found few technological weaknesses with performance measurement systems in this group. We did, however, observe shortcomings in managing the productivity improvement effort, with the result that performance measurement information is not used as extensively as it might be.

14.62 The considerable Headquarters effort that has gone into developing work measurement standards has not been used to the fullest extent by the regions. Although some regions used the Commission's national standards to calculate actual levels of efficiency, others developed their own "standards" based on historical performance. Some regions did not use standards at all. Consequently, one could not readily compare regional efficiency levels or establish national efficiency targets.

14.63 As an example of the lack of uniform standards, a sample of the larger offices in the Ontario Region reported an average efficiency in 1977 of 95%, against the Ontario historical standards. Against the work measurement standards developed by National Headquarters, the performance of the same offices over the same period appears to have been approximately 65%. This would indicate that the opportunity exists to achieve substantial benefits from improvement in efficiency.

14.64 No discernible efforts had been made and no clearly identifiable group existed to initiate and monitor productivity improvements. Improved management and clearer direction could substantially improve the effectiveness of the performance measurement and improvement effort.

14.65 *One common approach to developing standards, based on work measurement principles, should be used throughout the Benefit Programs group, co-ordinated by National Headquarters.*

14.66 Central Index. The primary function of the Central Index of the Canada Employment and Immigration Commission is processing, issuing and maintaining Social Insurance numbers for Canadian citizens and landed immigrants. Applications for Social Insurance cards are received in Ottawa or through the local offices of the Commission. In 1977, a total staff of 236 issued 1.2 million new and 350,000 replacement cards. Most Central Index functions are clerical, repetitive and easily measurable with performance measurement techniques. Our review of the management controls in Central Index concentrated on aspects that have an impact on operational efficiency.

14.67 Central Index management has made substantial efforts to manage the production and registry operations efficiently. It has developed work standards for certain activities and uses them, although only to a limited extent, to monitor work performance. Adjustments in operating procedures since 1975 have not been accompanied by adjustments in the standards and, consequently, the standards affected have simply been discarded. Only 30% of the measurable activities were being measured. In our opinion the extension and upgrading of the work measurement program could result in improved productivity.

14.68 For some key sections we compared the actual time reported with standards which we developed for this purpose from internationally accepted standard data. Based on this comparison, we estimated productivity for Central Index was about 65%. This indicates that there are still significant opportunities for improving efficiency.

14.69 *The Commission should ensure that measured work standards used by Central Index are updated when changes in operating procedures occur.*

14.70 Lair Market Policy. The Labour Market Policy group of the Canada Employment and Immigration Commission employs approximately 11,000 people in delivering employment services to the public, including counselling, testing, training and referrals to job openings.

14.71 The Labour Market Policy group has substantial areas that are amenable to performance measurement. Yet only some regions were reporting manpower utilization, while the national performance measurement activities included only volume counts such as the number of registrations, placements, etc. Consequently, national performance could not be measured and reported on a regular basis.

14.72 The data collected were essentially for supporting man-year budgetary requests. Our audit revealed a number of problems with the data, including:

- Standards were based on estimates which had not been validated through the use of work measurement.
- The data contained major errors. For example, the number of placements during 1977-78 accumulated from the monthly performance measurement data was 30% below the number reported by another monitoring system of the Commission for the same period.
- Output category definitions were not clearly understood and were interpreted differently by different users.
- An unnecessarily large number of volume counts were collected.

As a result, the data had little credibility and limited use as a basis for efficiency control. This group had little information suitable for guiding and assisting a productivity improvement effort.

14.73 *The Commission should undertake a study of the Labour Market Policy group to:*

- *seek and, if feasible, develop standards, based on work measurement principles, that can be used for efficiency improvement at the local office level;*
- *reduce and simplify the number of output volumes reported; and*
- *improve data reliability.*

14.74 Immigration and Demographic Policy. The Immigration and Demographic Policy group of the Canada Employment and Immigration Commission employs approximately 2,000 people. The functions of the group include screening and processing immigrants, the examination of people coming into Canada and the settlement of immigrants in this country.

14.75 The Immigration national performance measurement system has generated monthly reports since October 1976. It provides an efficiency index for each region and for the total sector, based on estimated standards.

14.76 We found serious inadequacies in this performance measurement system:

- The standards covered only a part of the work performed at the district and local office level. A multiplying factor ranging from 2 to 4 was used to account for the balance of the resources including such things as supervision, travel, idle time and other unmeasured activities. In other words, the actual measured work was only 25% to 50% of the total time allowed. The use of such a large multiplying factor is, in our view, inappropriate and makes historical and inter-regional comparisons of performance unreliable.

- The system did not differentiate between minimum manning locations, those where staff had to be on duty regardless of the workload, and those where staffing levels could be directly related to workload.
- Performance reports did not include quality and level of service indicators.

14.77 We found little evidence to indicate that management was using information provided by the performance measurement system or other productivity improvement techniques to increase the efficiency of labour in this group.

14.78 *The Commission should review the Immigration and Demographic Policy group's performance measurement system to determine:*

- *the activities for which standards, validated by work measurement techniques, are feasible;*
- *the extent to which a more uniform set of standards can be developed for use in all Regions; and*
- *the extent to which the system can be made to indicate actual levels of efficiency in order to determine potential for efficiency improvement.*

14.79 The Immigration and Demographic Policy group's performance measurement system should differentiate between minimum manning locations and those where staffing levels can be directly related to workload. Time used should be reported against meaningful activities which correspond to major output volumes. High priority should be given to the development of meaningful unit costs as overall indicators of performance to be combined with the use of measured work standards, where applicable.

Internal Audit

14.80 The internal audit function in the Canada Employment and Immigration Commission is the responsibility of the Internal Audit Bureau, which has 10 professional positions and an audit budget of approximately \$5.9 million for 1977-78. This included approximately \$5.2 million for audit services contracted from the Audit Services Bureau of the Department of Supply and Services.

14.81 We reviewed this function to determine whether the Commission was obtaining good value for money from its internal audit activities and to determine the extent to which these auditing activities could affect the nature, timing and extent of auditing we conducted.

14.82 General assessment. Our review of the activities of the Internal Audit Bureau indicated the following:

- The Canada Employment and Immigration Commission has not provided the Internal Audit Bureau with the necessary guidance and support to enable it to fulfil satisfactorily its role within the Commission.
- The direction the audit effort has taken reflects deficiencies in the selection of areas to be audited and in the choice of auditing approaches employed.

- Deficiencies in the method of reporting audit findings have resulted in significant observations not being sufficiently highlighted or emphasized and in the individual findings not being effectively consolidated or summarized to enable management to assess their significance properly.

14.83 Based on the above, we concluded that the Internal Audit Bureau has not been in a position to provide to the Chairman and the Vice-Chairman as much information and advice to assist them in the overall management of the Commission as could reasonably be expected of an internal audit function.

14.84 Although we believe there is considerable scope for improvement in certain aspects of the audit effort, we found that, given the audit objectives selected, the quality of the work performed was adequate and the Office of the Auditor General could rely on it in determining the extent of the examination that it needed to carry out in discharging the attest portion of its audit.

14.85 The more significant of our observations, which were reported to the Commission and on which we based the above conclusions, are outlined in the paragraphs that follow, under three general headings: Organizational status; Audit coverage and planning and Audit practice; review and follow-up.

14.86 Organizational status. In the course of our review for the fiscal year ended March 31, 1978, we noted that:

- no mandate existed outlining the role and responsibilities of the Internal Audit Bureau;
- the Director of the Internal Audit Bureau reported to the Executive Secretary;
- there was no properly functioning Audit Committee; and
- no mechanism or system was in place to ensure the proper coordination of all audit and evaluation activities within the Commission.

14.87 In April of 1978, the Commission issued a tentative mandate for the Internal Audit Bureau. This mandate briefly discussed the responsibilities of the Bureau and recommended, among other things, that:

- the Internal Audit Bureau should report to the Chairman/Vice Chairman through the Executive Secretary; and that
- an Audit Committee be established.

14.88 In our opinion, the proposed mandate did not describe in sufficient detail the purpose, authority and responsibility of the audit function. Also, we believe that if the Director of Internal Audit does not directly report to the Chairman/Vice-Chairman, a buffer is introduced which diminishes the Director's access to top management and, to a degree, diminishes the perceived importance of the Internal Audit Bureau to other members of the Commission. All these factors contribute to an apparent lack of management support for the internal audit function. The Commission has subsequently taken action in this regard.

14.89 *The internal audit function should have a mandate which sets out in a clear and concise manner, the purpose, authority and responsibility of the audit function. This mandate should be*

approved by the Chairman/Vice-Chairman and be widely distributed to demonstrate visible support of the audit function by the senior executives in the Commission.

14.90 *The Director of Internal Audit should report directly to the Chairman/Vice-Chairman.*

14.91 *An Audit Committee should be established to co-ordinate all the audit and evaluation activities, provide guidance to the audit group and determine that appropriate action is taken on audit findings.*

14.92 Audit coverage and planning. We found no evidence of a formalized process to define the audit universe and to identify all potential auditable areas. Our review indicated that certain important auditable areas which should have been considered in the audit selection process had not been considered.

14.93 In reviewing the types of audits performed we noted the following:

- extensive deployment of resources on audits of contribution programs in the Labour Market Policy and the Immigration and Demographic Policy groups. For 1977-78, \$3.5 million out of a total of \$4.8 million was budgeted for this activity. These audits consist primarily of verifying expenditures on specific projects by reviewing supporting documentation and the project agreement. Certain aspects of this task are more of a financial control process than an audit process.

For the most part, these procedures do not require a high level of accounting or auditing knowledge and could be completed at a much lower cost by project monitors. A relatively simple and inexpensive training course, supported by good accounting and procedural manuals would be needed if this course of action were selected. The audit requirements could then be met by reviewing these procedures, reviewing the monitoring process and verifying a limited number of projects. The cost of this audit process along with the increased project monitoring costs would probably be lower than current audit costs.

Finally, the audit reports produced (in excess of 2,000) by this process were not subject to any follow-up procedures.

- insufficient operational audits in the Labour Market Policy and the Immigration and Demographic Policy groups. A relatively small portion of the resources was allocated to operational audits in the Labour Market Policy and the Immigration and Demographic Policy groups. The value of operational audits in an organization as complex and decentralized as the Canada Employment and Immigration Commission cannot be over-emphasized.
- insufficient functional audits. The audit of individual components or responsibility centres in an organization is a valid concept but it has to be supplemented by audits which cross organizational and geographic divisions. These audits should examine the total function as opposed to its component elements to evaluate properly the existing systems.
- lack of integrated audits. A lack of co-ordination and communication between all the audit/evaluation groups resulted in the absence of integrated or all-inclusive audits which should be performed on any one sector of the Commission. The Commission lacks the

benefits to be derived when a particular segment or fragment of an organization is subjected to a complete and integrated evaluation of its activities.

14.94 The above observations reflect deficiencies in both the selection of areas to be audited and in the choice of auditing approach employed.

14.95 *The Commission should institute a formal planning process to ensure the proper selection of areas to be audited.*

14.96 *The contribution program audit process should be re-examined with the objective of clearly distinguishing between auditing and those financial control functions that should be the responsibility of program personnel.*

14.97 *The Commission should initiate guidelines on the types of audits to be performed, with a view to placing more emphasis on functional and integrated audits.*

14.98 Audit practice, review and follow-up. As noted previously, while we do not believe that the departmental audit effort has been directed to those areas where it would yield the greatest benefit, we found that the way in which the work was being performed was generally adequate.

14.99 The working papers reflected the proper documentation of audit procedures and indicated that the audit work adhered to generally accepted auditing standards. In addition, standard audit questionnaires and programs have been developed and updated when necessary. The working papers were complete and reasonably well organized. They reflected the work done and supported the audit findings, and appropriate conclusions were drawn from the findings.

14.100 In summary, the audit work done was found to be satisfactory, with the following exception:

the concept of materiality in the audits performed was not well established. Although the auditors appeared to have a general understanding of the concept and tended to place greater emphasis on the more significant items, materiality was not defined in dollar terms and the determination of the amount of the audit effort was not sufficiently related to materiality.

14.101 Summary reports are an important vehicle for informing management of the results of the audit process and for pinpointing those areas to which management should be directing its attention. The summary reports for the Labour Market Policy and the Immigration and Demographic Policy groups have not achieved this in the past. These reports tended to present an aggregation of facts rather than an evaluation of their significance. Our review indicated that an attempt is being made at improving this process for the coming year.

14.102 In a few instances we noted that the audit work performed by the Internal Audit Bureau and the Audit Services Bureau had disclosed significant deficiencies. These deficiencies had not, however, been properly communicated to management. In reviewing 15 internal audit reports, we noted that seven contained observations that an important control procedure was not being carried out. Had this observation been reported clearly and concisely in a summary report, management would probably have acted on it. Instead, no action was taken and the deficiency was reported on by the Auditor General's Special Study on Grants and Contributions in 1977. Also, a 1977 study by the Office of the Auditor General on the Benefit and Overpayment System in the Benefit Programs group, disclosed an estimated \$95 million of undetected overpayments. Although internal audits were not designed to

quantify the amount of potential overpayments, the seriousness of the situation was referred to in a number of individual reports. If the findings had been properly presented and reviewed, the situation would have been disclosed earlier and appropriate remedial action could have been taken sooner.

14.103 A level of materiality should be determined for each audit assignment and the work performed should be related to this level.

14.104 Summary reports should be prepared as required to consolidate the findings of audits and to advise management of serious problems to which attention should be devoted. These summaries should analyze and evaluate the data which have been collected and they should highlight and emphasize the most significant matters.

14.105 A follow-up policy should be established for every audit report to ensure that appropriate action has been taken. This should include both contribution program audit reports and summary audit reports.

Benefit Programs Group

Background

14.106 The Benefit Programs group employs two major sets of financial systems:

- the Benefit and Overpayment System (BNOP system) including program administration which controls the initiation and payment of approximately \$4,000 million per annum of unemployment insurance benefits; and
- the general accounting systems which control approximately \$235 million per annum in administrative costs.

14.107 In 1976, the Computer and Information Systems Evaluation (CAISE) study subjected the BNOP system to an intensive review of controls. The results of that review were reported in our 1977 annual Report (Chapter 6). In summary, the CAISE study assessed overall controls in the BNOP system to be inadequate since:

- controls and procedures were not adequate to ensure that the initial and continued eligibility of individual claims was validated prior to the issue of claim warrants; and
- control over input documents was not adequate to ensure that unauthorized input was not entered into the system and valid transactions were not lost.

14.108 In light of these weaknesses, the Office of the Auditor General initiated a further study to quantify, through properly designed tests of actual benefits paid in 1976, the amount of any overpayment of benefits which might have occurred as a result of such weaknesses. The results of these tests were reported in our 1977 Report (paragraph 17.10). In summary, these extended tests indicated that the Commission made approximately \$95 million of overpayments in 1976 which were not previously identified by its regular control activities.

14.109 The Commission, after reviewing the results of the 1976 tests and the verification work, concurred with the conclusions. For the examination of 1977 benefit payments, the Commission provided personnel from the Control Branch to assist the Office in the verification process.

14.110 For 1977, our examination of the Benefit Programs group included the following:

- an examination of the Benefit and Overpayment System which involved a review of the internal controls at 30 district offices, and a statistical sample of benefits paid, to estimate the extent of undetected benefit overpayments;
- a follow-up of last year's CAISE study to monitor the progress made by the Commission in implementing changes in the BNOP system to rectify the weaknesses identified in this study;
- a review of the development of the on-line benefit pay system; and
- an examination of the financial accounts, which included a review of the general accounting systems and tests of transactions in all regions.

14.111 In summary, the examination concluded that:

- the Commission's regular control activities did not detect benefit overpayments in 1977 which were estimated to be \$142 million (lying within a possible range of \$99 million to \$179 million);
- significant control weaknesses in the BNOP system continue to exist;
- previous to April 1978 there was no evidence that the new online benefit pay system had been reviewed by the Finance Division or any other internal group to ensure that appropriate internal controls and audit trails had been incorporated into its design; and
- the accounting systems other than the BNOP system, are generally functioning adequately.

Examination of the Benefit and Overpayment System

14.112 The Office selected a statistical sample of 1,033 claimants to whom benefits had been paid during 1977 and performed a verification of their claims. It also carried out a review and evaluation of internal control procedures in 30 of the Commission's district offices.

14.113 This verification indicated that some of the Commission's controls are operating effectively and that a substantial dollar value of benefit overpayments (in 1977 approximately \$67 million) is being detected regularly and, in most cases, recovered. However, the results of our specific tests also indicated that during 1977 a significant additional amount of benefit overpayments (lying within a possible range of \$99 million to \$179 million) escaped detection by the Commission, that a further significant amount of claims were subject to deviations from laid-down procedures, and that a large but unquantifiable category of claims was subject to conditions which could invite abuse. The increase in benefit overpayments which escaped detection by the Commission (estimated at \$95 million in 1976 and \$142 million in 1977) has resulted from a number of factors including increased benefit payments and improved use of available detection procedures in the conduct of the examination.

14.114 Exhibit 14.3 summarizes the sample results.

Exhibit not available

14.115 It should be noted that a certain degree of imprecision is associated with the results of any statistical sample, because we have not audited the entire population of approximately 2.5 million claimants. Our best estimate of the amount of overpayments in the population projected from our sample results is \$142 million. The imprecision of this "most likely value" is indicated by the size of the probable and possible ranges noted in Exhibit 14.3. The degree of imprecision indicated in these ranges is a reflection of the limited sample size which was felt to be appropriate under the circumstances and at least sufficient to distinguish between trivial and non-trivial incidences of overpayments.

Exhibit not available

14.116 Results of sample verification. For purposes of the testing procedures, an overpayment was defined as any benefit paid which, under existing legislation, the claimant should not have received and which would have been legally recoverable had it been discovered and dealt with immediately.

14.117 We classified as "identifiable overpayments" any claim which the available evidence proved conclusively to contain an overpayment. Within the sample of 1,033 claims, 253 claims were classified as identifiable overpayments. Projecting the effect of these 253 sample overpayments to total annual payments of approximately \$3,900 million indicated that total overpayments lay within a possible range of \$93 million to \$161 million (line (a) in Exhibit 14.3).

Exhibit not available

14.118 "Potential overpayments" (any claim which the available evidence demonstrated persuasively, although not conclusively, to contain an overpayment) lay within a possible range of \$5 million to \$39 million (line (b) in Exhibit 14.3).

Exhibit not available

14.119 The Commission's policies require certain procedures to be followed in monitoring the claimant's continuing eligibility to receive benefits. The Commission relies, to a certain extent, on Canada Manpower Centres to assist in this monitoring effort. In the sample of 1,033 claims, 257 were subject to monitoring efforts which were felt to be inadequate. The projecting effect of these 257 cases is that, within the \$3,900 million population, claims whose gross value was approximately \$950 million (\$500 million in 1976), were probably subject to similarly deficient follow-up of the claimant's continuing eligibility (line (c) in Exhibit 14.3). Some portion of this amount could therefore represent an overpayment.

Exhibit not available

14.120 A "compliance deviation" was defined as any case where, although it was felt a related overpayment did not occur, a prescribed procedure was not adhered to. Within the sample of 1,033 claims, 453 not included in results already reported were subject to compliance deviations although they did not (as far as can be determined) contain an overpayment. The projecting effect of these 453 claims is that, within the \$3,900 million, \$1,500 million (\$1,000 million in 1976) were probably subject to similar deviations (line (d) in Exhibit 14.3).

Exhibit not available

14.121 A number of cases were identified which, while perhaps not technically overpayments, suggest the possibility of abuse. The term "abuse" is used to connote discrepancy with the apparent intent of the Act and in particular its insurance objective and its eligibility requirements of active job search. That is, although these cases may not strictly be in violation of the provisions of the Unemployment Insurance Act prevailing at the time, one can seriously question whether they correspond to the Act's intent.

14.122 From the requirements of the Act, it would seem reasonable to infer that the intent of the law is: to insure a contributor against loss of earnings during temporary unemployment while he is actively seeking and, within limits, until he obtains other suitable employment. However, the review conducted by the Office revealed several situations in which this was not the case.

14.123 For example, there are claimants who would not otherwise be entitled to receive benefits except for their participation in federal and provincial job creation programs, since they have not been in the past and may not seriously intend to be in the future, permanently attached to the labour force (or regularly contributing unemployment insurance premiums). In such cases the minimum employment required to qualify for benefits is sufficiently short to cause the program to function more as a welfare plan than an insurance plan. Although these programs do not violate the Act, the federal programs are somewhat inconsistent with its insurance objective, and the effect of the provincial and municipal programs is to transfer some portion of welfare costs from provincial administration to the federal Unemployment Insurance program.

14.124 The Act does not prohibit "sham transactions" - entered into solely for qualifying someone to receive benefits who would not otherwise qualify, or of maximizing the amount of those benefits rather than for any bona fide business purpose. Such transactions may therefore take place with no penalty being imposed.

14.125 The effect of this potential for abuse is not to create legal overpayments which could be recovered, but rather to permit disbursement of benefits in circumstances to which the Act may not have been intended to apply. Because these abuses are related to ambiguities, omissions, faulty interpretations or unintended applications of the law, any value assigned to their possible magnitude would be highly arbitrary. Thus, it would not be meaningful to attempt to estimate even the gross dollar value of claims possibly subject to such abuse.

14.126 A further 31 claims were found to contain underpayments. Projecting the effect of these amounted to \$10 million (\$7 million in 1976), lying within a probable range of \$6 million to \$18 million and within a possible range of \$3 million to \$34 million. Because this study was concerned primarily with the existence of overpayments, underpayments have not been included in the discussion and analysis.

14.127 System weaknesses. It would be unrealistic to expect any practicable control system to prevent or detect all actual or potential overpayments of benefits. The cost of additional prevention or detection procedures beyond a certain level could well exceed the value of the reduction in overpayments achieved. Therefore, in such situations a cost-effective control system must necessarily stop short of 100% control.

14.128 Nonetheless, as evidenced by the results of the study, there is a need for further preventive controls to be incorporated into the system to detect or prevent certain overpayment conditions indicated by our tests. We found the Commission to be interested in improving its controls where

possible. The Commission has addressed these weaknesses; however, as noted later in this Report, no major changes have been implemented.

14.129 As noted in our 1977 Report, control deficiencies were identified in the areas of the validation of initial and continuing claims data (paragraph 6.47) and the control of documents and input data (paragraph 6.48). The review conducted by the Audit Office indicated that these weaknesses still exist in the Benefit and Overpayment System. As a result of these weaknesses, overpayments, erroneous payments, or benefits obtained through fraud continue to be a possibility. Our tests indicated that approximately \$55 million of overpayments resulted in large part from the existence of these deficiencies in control.

14.130 Our study also noted inconsistencies between local offices in interpretation of policy. For example, policies relating to eligibility and monitoring of claimants as stated by the Commission and outlined in various administrative documents allow for wide variations in the interpretation of the Unemployment Insurance Act. Changes in laid-down procedures are being established at a local office level rather than at a regional level. As a result, claimants in similar circumstances may not be consistently treated within a region or between regions.

14.131 As well, the statistical sample indicated that an amount (approximately \$10 million) of overpayments can be attributed to employers incorrectly preparing the appropriate document (Record of Employment) on which the Commission bases the benefit payment.

14.132 *Based on the results of our examination we concluded that:*

- *to properly evaluate the progress and effectiveness of any changes to the system of internal control, the Commission should perform similar tests in future years;*
- *changes to laid-down procedures should be reviewed at a regional level to reduce inconsistencies in the interpretation of policy; and*
- *efforts should be made to reduce the incidence of clerical errors made by employers in the preparation of the Record of Employment forms.*

Follow-up on the 1977 Computer and Information Systems Evaluation Study

14.133 As set out previously, the Computer and Information Systems Evaluation (CAISE) study raised two major concerns about the BNOP system. We set out below the progress which has been made by the Commission in addressing each of these areas.

14.134 Validation of initial and continuing claims data. The Record of Employment (ROE) document (issued by employers to employees on termination) and the associated Record of Employment sub-system of the BNOP system are central to the validation of both the initial and continued eligibility of individual claims for unemployment insurance benefits. The initial eligibility of the claimant is based largely on the ROE document which the claimant presents when applying for benefits. In addition, the ROE sub-system uses information from the document to check the continuing eligibility of claimants by identifying overlapping periods of employment and benefit pay periods. Such incidents of overlap are followed up and investigated by Benefit Control officers in the "Post-audit" program.

14.135 Last year's study identified a number of weaknesses in the current ROE system. Accordingly, it recommended (paragraph 6.47) that:

... the control procedures covering the operation of the present Record of Employment system be strengthened and that additional procedures be developed to control input and processing of Record of Employment documents.

14.136 In response to this recommendation, the Commission has undertaken a number of studies and pilot projects with a view to implementing revised procedures for processing these documents. In particular:

- the document has been redesigned to facilitate the capture of relevant information both from local offices and directly from employers;
- the new system has been designed to control the distribution of the documents and to ensure that they are received from the same employer to whom they were issued;
- a new system has been designed to ensure that Record of Employment information is captured for all claims processed; and
- the Record of Employment system has been redesigned to include a comparison of information reported by employees with that reported by employers in connection with terminations and to report all discrepancies.

14.137 The above system changes are now undergoing pilot tests in one region. Once evaluated, these systems will be implemented on a national basis. It is expected that this will occur in early 1979.

14.138 The above system changes, if implemented, will significantly enhance control over the processing of Record of Employment information and hence, control over the initial eligibility of claims.

14.139 Last year's study also observed that the exclusive use of information on the Record of Employment, as a means of verifying the continued eligibility of claimants, does not always lead to timely reporting of potential overpayments. The present Record of Employment system is designed to compare the data on a subsequent ROE (i.e., an ROE issued upon termination following a benefit pay period) to data on file related to a previous benefit pay period. Thus, several months may elapse before a potential overpayment is identified and the chances for recovery of the overpayment amount reduced. The study in part recommended (paragraph 6.47) that:

In the long term, the Commission should expedite its studies to evaluate the feasibility of using additional sources of information for the verification of claims eligibility.

14.140 In response to this recommendation the Commission has developed a new system (called Information on Hirings System) which would require employers to supply the Commission with information on the hiring of new employees. Using this information, the Commission would be able to identify claimants who are employed and claiming benefits at the same time. The Commission is now testing the new system on a pilot basis in six centres. Once these pilot tests have been completed and evaluated, it is expected that the system will be implemented on a national basis in 1979.

14.141 In our opinion, the proposed Information on Hirings System, if implemented on a national basis, would constitute a significant improvement on the validation of the continuing eligibility of claimants.

The major benefit of the system would be its effect as a deterrent to benefit overpayments as opposed to the identification of actual overpayments.

14.142 Control of documents and input data. The second major concern made by the study relates to document control procedures. Under the present system, insurance agents within district offices are responsible for making a wide range of "decisions" about insurance claims. Such decisions include the initial decision to establish a benefit pay period as well as a variety of subsequent decisions which revise or renew initial claims. The agents record decisions on prescribed input documents which are then forwarded to the regional pay centre for processing and updating of the main Benefit Pay system master files.

14.143 The concern expressed in the CAISE study relates to the lack of an effective document control system to prevent the entry of unauthorized decision documents and the inadvertent loss of authorized documents before processing by the regional pay centre. As a consequence of these weaknesses, the study concluded that it was possible for UIC employees, both at district offices and regional pay centres, to initiate unauthorized decisions and thereby effect fraudulent payments of benefits. In addition, the weaknesses could result in the loss of valid and authorized documents such as disqualification and disentitlement decision documents. The study accordingly recommended (paragraph 6.48) that:

The new document control system currently being developed by the Commission should include procedures to enable the district office to ensure that all and only those transactions which have been authorized and approved by insurance agents are processed by the regional pay centres.

14.144 In response to this recommendation, the Commission has developed a new national document control system (called Decision Monitoring System). Although we have not yet had an Opportunity to review the final design specifications for this system, we understand it will make it possible for district offices to control effectively the processing of agent decisions by the regional pay centres. The new system is scheduled for pilot implementation in late 1978, with national implementation by early 1979.

14.145 During our 1977-78 audit review and tests, we found further evidence of errors resulting from the lack of adequate document control procedures. In particular, we found:

- evidence of poor control over claims registers within most of the district offices we visited;
- several district offices that did not make proper use of the present document control system exception reports (e.g., of unregistered claims);
- the current document control system was not applied to "revised" decisions (which represent approximately 55% of all decisions);
- corrections of errors might bypass the regular document control system since they were frequently communicated to the regional pay centre by district offices by telephone; and
- evidence of overpayments due to the inadvertent loss of authorized agent decisions.

Development of On-line Benefit Pay System

14.146 In 1975, with Treasury Board approval, the Commission initiated a project to study the feasibility of developing a new on-line benefit payment system. During the last three years, a pilot system which uses on-line terminals for asking about the status of individual claims and for the input of agent decision data has been developed and implemented in three local offices. This new system will have a major impact on the controls which are exercised over benefit payments. For example, access to an on-line terminal within a local office could provide the ability to initiate or change a claim for benefits. The new system is being evaluated for national implementation over the next two to three years.

14.147 The new on-line system, if properly designed and implemented, could have a very positive effect on the basic control over benefit payments. For example, an on-line system would not require local offices to submit documents to regional pay centres and thus cumbersome document control and error correction procedures would be avoided. However, previous to April 1978, we found no evidence that the new system had been reviewed by the Finance Division or any other internal group to ensure that appropriate internal controls, audit and management trails had been incorporated into its design. The possibility exists, therefore, that the new system will be implemented without adequate financial controls.

14.148 *A review of the adequacy of the financial controls being incorporated into the new on-line system should be performed by the Commission before its further implementation in other regions or district offices.*

Examination of the Financial Accounts

14.149 The general accounting systems in the Benefit Programs group, other than in the Benefit and Overpayment System, control approximately of administrative costs and other accounting data. Our review of these systems indicated that they are generally functioning adequately. We did, however, note that control procedures are not adequate to ensure that the overpayments identified by the Commission are properly recorded or controlled after their identification. As a result, the possibility exists that overpayments could be identified by the Benefit and Overpayment System and then lost due to deficiencies in the accounting system.

14.150 The Commission is aware of this problem and has recently begun to implement revisions to the existing system. The Office will review the effectiveness of these revisions once they have been implemented.

Labour Market Policy and Immigration and Demographic Policy Groups

Background

14.151 A systems-based audit approach was employed to examine the accounts of the Labour Market Policy and the Immigration and Demographic Policy groups of the Commission. This examination included a review of the financial control systems and a testing of transactions in all major programs and activities in all regions. The major areas subjected to review were:

	1977-78 (in millions)
Purchase of training and training improvement	\$ 305

Canada Manpower Training Program allowances and trainee travel	191
Canada Works	237
Young Canada Works	26

14.152 The audit procedures performed were not designed to detect all systems deficiencies and errors but rather to assess the adequacy of the systems in place and to satisfy ourselves that no material deficiencies or errors had occurred, which would affect the Auditor General's opinion on the Financial Statements of Canada. The audit procedures were also designed to determine whether moneys due to Canada were received, fully accounted for, and expended for the purposes for which they were appropriated by Parliament, and whether expenditures had been made as authorized.

14.153 In 1977, this Office conducted a special study on Grants and Contributions in the former Department of Manpower and Immigration. This comprehensive study made numerous observations. Any findings from the current year's review which were previously reported as a result of the 1976-77 Grants and Contributions study are not repeated here. A follow up of this study will be performed in the coming year.

14.154 Our major findings arising out of our current study are set out in the paragraphs that follow.

Purchase of Training

14.155 Payments to provinces. For the 1977-78 fiscal year, payments to the provinces for training purchases were budgeted at approximately \$300 million. This amount represents almost 24% of all expenditures for the Labour Market Policy and the Immigration and Demographic Policy groups which were budgeted at approximately \$1,300 million.

14.156 The Commission makes interim payments to the provinces for courses it purchases. We noted that in certain provinces interim payments were neither in line with nor dealt with in federal-provincial agreements. In one province monthly payments for purchased courses are based on 1/12 of the total estimated cost for the year. The federal-provincial agreement specifies that interim payments will be based on an amount consistent with the volume of training for the month. In another province the same practice is employed; however, in this case, no provision exists in the agreement which specifies the basis for interim payments. By not specifying the basis for interim payments in the federal-provincial agreements the Commission in effect relegates the decision to the Regions. This may lead to dissimilar payment practices across the country. It may also give rise to the problems outlined in the next paragraph.

14.157 There is no assurance that payments made are in line with services received. Given the magnitude of the amounts involved, the timing of payments will significantly affect both the Commission's cash management and the related interest costs to the Federal Government. Also, control is diminished by these procedures since the monthly payments become routine instead of having to be supported by evidence of the training provided.

14.158 *Federal-provincial agreements should clearly specify the basis for interim payments and this basis should be observed by all Regions in making such payments.*

14.159 Training courses rates. On a yearly basis, the Federal Government and the provinces negotiate the amount of training and the applicable costs. The cost is funded by the Federal Government. As outlined in paragraph 14.36, we noted deficiencies in the negotiation process.

14.160 Cost certification. Education is a provincial matter. Accordingly the provinces supply the training courses which are funded by the Federal Government. The provinces supply the Commission with an annual statement of costs for courses purchased. The Commission does not subject these costs to an audit but provision is made in the federal-provincial agreement for their certification by the province. This is the only assurance the Commission has as to the fairness of the reported provincial costs.

14.161 We noted significant delays in receiving this certification. At the time of our review, certain regions had not yet received cost certification from the provinces for costs related to the 1975-76 fiscal year. This situation makes it difficult for the Commission to discharge its responsibilities satisfactorily. It should also be noted that the certifications which are received are not necessarily from an independent third party, e.g., the provincial Auditor General. The Commission has recognized this problem and is negotiating with the provinces to rectify the situation.

14.162 *The federal-provincial agreements should continue to make provision for the timely certification of costs. The Commission should pursue with the provinces the possibility of amending the federal-provincial agreements so as to provide for alternate procedures should the certifications not be forthcoming.*

Training Improvement Program

14.163 This Program is intended to promote improvements to the Canada Manpower Training Program. For the year ended March 31, 1978, budgeted expenditures amounted to approximately \$4 million. To achieve the program objective, the Commission funds individual studies. These studies are supposed to culminate in a report from which program improvements may be initiated.

14.164 We found no evidence indicating that all project reports received by the Regions had been reviewed. We also found no evidence indicating that all recommendations outlined by the various studies had been followed up. The Commission is not ensuring that the funds it expends on these individual project studies are effectively used.

14.165 *A standard procedure for reviewing all Training Improvement reports should be established and a follow-up program devised, where appropriate, to ensure that the maximum benefit is derived from the reports.*

Canada Works Program

14.166 This job creation program funds approximately 6,000 projects and had a budget of approximately \$245 million for the 1977-78 fiscal year. One of the criteria for project funding by the Commission is that the project activities be in addition to the normal activities of the project sponsor.

14.167 We noted that some municipalities acted as sponsors for several projects. A few of the project descriptions were as follows:

- inventory taking in a vocational school;
- cemetery upkeep;
- demolition of municipal buildings; and
- painting municipal buildings.

14.168 Although we have not reviewed these projects in detail, it would appear that certain of them might be considered normal for a municipality and not the types contemplated by the program objectives.

14.169 *The Commission should review the way in which Canada Works program funds are being used, develop clearer guidelines and ensure that program criteria are observed.*

Other Operating Expenditures

14.170 Advertising contracts - National Headquarters. During our review, we noted that for the past several years the Commission has requested and received approval from the Treasury Board, for authority to enter into advertising services contracts without inviting tenders. Such contracts amounted to \$1.2 million in 1977 and \$3.2 million for the first five months of 1978. Approximately 80% of these contracts were directed to the same advertising agency.

14.171 Section 8 of the Government Contracts Regulations specifies that "the contracting authority shall invite tenders" but provides for four exceptions. In our opinion, the explanations given to support the requests not to invite tenders have not met the criteria for specified exceptions.

14.172 *Although the Treasury Board approved these submissions, we believe that the Commission should follow the Government Contracts Regulations and invite competitive tenders for advertising contracts.*

Improperly Drafted Agreements

14.173 Labour Market Policy group programs provide for the payment of contributions which may result in overpayments by the Commission. Our review disclosed that during 1977-78, the Commission erased from its accounts over-payments of \$838,000 which had been accumulated from 1971 to 1975 inclusive.

14.174 Agreements under one of these programs contained a litigious clause which was corrected in 1975. In 1976 a legal opinion was requested by the Commission and in December 1977, the Department of Justice concluded that since the agreements:

"... contained settlement provisions on termination of the agreement that deemed all monies received to have been made in full and complete settlement of the agreement, there could not be a debt created at that point."

14.175 The lack of an adequate and proper contract clause resulted in losses to the Crown.

14.176 *Standard agreements for all contribution programs should contain clauses to ensure that collection of overpayments can be pursued.*

Summary of Recommendations and Commission's Comments

Recommendations

Studies of Procedures in Cost Effectiveness

Canada Manpower Training Program

14.35 The Commission should continue its efforts to rationalize the allocation of funds to provinces and should explore means of redressing more rapidly the regional imbalance between training purchases and training needs, in line with the stated goals of the program.

Commission's Comments

Agreed. The Commission will continue to rationalize the allocation of funds as rapidly as possible consistent with the availability of funds and government policies.

Recommendations

14.37 The Commission should strengthen its negotiation of course prices and provincial overhead. To facilitate this, action should be taken to ensure better pricing information. Financial expertise should be strengthened where necessary to offer a better negotiating capability.

Commission's Comments

Agreed. To improve the regions' perception of their roles a three level plan of action is being implemented. As part of this plan regional officers, both program and financial will be counselled in negotiating techniques as appropriate to CMTP by an NHQ team composed of both financial and training branch officers.

Recommendations

14.43 The Commission should make every effort to improve the technical quality of its evaluations, adding lines of investigation that could assist in explaining the measured impact of training, and in providing better interpretations and qualifications of reported results. The Commission should also initiate evaluations of the impact of training allowances, the candidate selection process and the course purchasing procedures.

Commission's Comments

Agreed. The Commission is in the process of undertaking a survey for the Canada Manpower Industrial Training Program.

Recommendations

Local Initiatives Program

14.47 Before undertaking an effectiveness evaluation, the Commission should explore the extent to which program goals can be expressed in measurable terms. The Commission should then determine the reasonableness of attempting to measure the effectiveness of the program.

Commission's Comments

Agreed. The Commission now makes a sharp distinction between exploratory studies and those seeking direct measures of program effectiveness.

Recommendations

14.50 The Commission should ensure that appropriate terms of reference are developed for evaluation studies. In addition, it should improve the planning and conduct of the studies by satisfying itself as to the adequacy of the research design and by monitoring more closely the technical aspects of the studies.

Commission's Comments

Agreed.

Recommendations

14.52 The Commission should critically examine evaluation reports to identify the strengths, weaknesses and limitations of their methodology and data. The examination would confirm or qualify the conclusions of the evaluation reports and form an integral part of them.

Commission's Comments

Agreed. All future major evaluation reports will include, as an integral part, a section dealing with the strengths, weaknesses and limitations of their methodology and data.

Recommendations

14.54 The Commission should develop information to ensure that in determining the most effective allocation of departmental resources it gives due regard to the impact of changes in project funding, levels of service, and size and types of projects.

Commission's Comments

Agreed. A study has begun to develop a resource forecasting model for the major job creation programs. Administrative resources demands and allocations will be based on such findings.

Recommendations

Department Performance Measurement Systems

14.65 One common approach to developing standards, based on work measurement principles, should be used throughout the Benefit Programs group, co-ordinated by National Headquarters.

Commission's Comments

Because of the high potential for change in local office configuration during integration and the attendant effect on claims handling procedures this measurement of activity has been given less emphasis than quality of decision-making and "level of service" indicators. Once reasonable office

configuration stability has been achieved, emphasis will again be placed on developing a common approach to efficiency measurement.

Recommendations

14.69 The Commission should ensure that measured work standards used by Central Index are updated when changes in operating procedures occur.

Commission's Comments

In view of the impending relocation to Bathurst with its relevant impact on procedures, physical relocation, etc., a decision was made not to re-study the work in Central Index. Once stability has been attained at Bathurst, the standards will be updated.

Recommendations

14.73 The Commission should under-take a study of the Labour Market Policy group to:

- seek and, if feasible, develop standards, based on work measurement principles, that can be used for efficiency improvement at the local office level;
- reduce and simplify the number of output volumes reported; and
- improve data reliability.

Commission's Comments

The Commission is presently studying the feasibility of developing work measurement standards in this area but it must be pointed out that these functions are less susceptible to work measurement than those in Immigration or Benefit Programs.

Recommendations

14.78 The Commission should review the Immigration and Demographic Policy group's performance measurement system to determine:

Commission's Comments

Agreed. The Commission's intention is to improve the present design in line with a number of the recommendations made and our own further development plans.

Recommendations

- the activities for which standards, validated by work measurement techniques, are feasible;
- the extent to which a more uniform set of standards can be developed for use in all Regions; and
- the extent to which the system can be made to indicate actual levels of efficiency in order to determine potential for efficiency improvement.

Commission's Comments

The same standards are now used for all ten regions.

Recommendations

14.79 The Immigration and Demographic Policy group's performance measurement system should differentiate between minimum manning locations and those where staffing levels can be directly related to workload. Time used should be reported against meaningful activities which correspond to major out-put volumes. High priority should be given to the development of meaningful unit costs as overall indicators of performance to be combined with the use of measured work standards, where applicable.

Commission's Comments

Agreed. Work is continuing on the development of unit costs as overall indicators of performance measurement.

Recommendations

Internal Audit

14.89 The internal audit function should have a mandate which sets out in a clear and concise manner, the purpose, authority and responsibility of the audit function. This mandate should be approved by the Chairman/Vice-Chairman and be widely distributed to demonstrate visible support of the audit function by the senior executives in the Commission.

Commission's Comments

Agreed. The mandate for the internal audit function was approved by the Chairman on July 27, 1978 and distributed throughout the Commission in August.

Recommendations

14.90 The Director of Internal Audit should report directly to the Chairman/Vice-Chairman.

Commission's Comments

Agreed. It is so stated in the mandate.

Recommendations

14.91 An Audit Committee should be established to co-ordinate all the audit and evaluation activities, provide guidance to the audit group and determine that appropriate action is taken on audit findings.

Commission's Comments

Agreed. The Audit Committee is now established. Its responsibilities include reviewing, evaluating and making recommendations on policy, plans, reports and assessing the extent to which audit findings were considered and effective action taken.

Recommendations

14.95 The Commission should institute a formal planning process to ensure the proper selection of areas to be audited.

Commission's Comments

Agreed. Further development and refinement of the existing procedures for 1979-80 are contemplated to meet requirements.

Recommendations

14.96 The contribution program audit process should be re-examined with the objective of clearly distinguishing between auditing and those financial control functions that should be the responsibility of program personnel.

Commission's Comments

Agreed. A re-examination of the contribution audit process will be carried out to ascertain respective responsibilities.

Recommendations

14.97 The Commission should initiate guidelines on the types of audits to be performed, with a view to placing more emphasis on functional and integrated audits.

Commission's Comments

Agreed. New guidelines will be issued in the next few months as part of a total review underway to examine the relationship between audits and operational reviews/effectiveness reviews.

Recommendations

14.103 A level of materiality should be determined for each audit assignment and the work performed should be related to this level.

Commission's Comments

Agreed. Greater emphasis on the application of the concept of materiality will be applied in selecting audit projects and assigning resources to them.

Recommendations

14.104 Summary reports should be prepared as required to consolidate the findings of audits and to advise management of serious problems to which attention should be devoted. These summaries should analyze and evaluate the data which have been collected and they should highlight and emphasize the most significant matters.

Commission's Comments

Agreed. The Internal Audit Bureau will continue to improve and expand the process for producing summary reports and to draw attention of management to serious problems.

Recommendations

14.105 A follow-up policy should be established for every audit report to ensure that appropriate action has been taken. This should include both contribution program audit reports and summary audit reports.

Commission's Comments

Agreed. A revised follow-up procedure will be implemented.

Recommendations

Benefit Programs Group

Examination of the Benefit and Overpayment System

14.132 Based on the results of our examination we concluded that:

- to properly evaluate the progress and effectiveness of any changes to the system of internal control, the Commission should perform similar tests in future years;

Commission's Comments

Agreed. Planning is now complete for a similar test of the Benefit Pay System of internal control in 1979. This test will be based on 1978 claims and will be carried out so as to provide comparability to the Auditor General's tests on 1976 and 1977 claims.

These tests will be repeated periodically in order to assess progress in internal control effectiveness.

Recommendations

- changes to laid-down procedures should be reviewed at a regional level to reduce inconsistencies in the interpretation of policy; and

Commission's Comments

Agreed. The internal audit plan for 1978-79 includes an audit to determine whether CEIC policies, procedures, directives and other work instruments related to claims adjudication and investigation and control are adequate, take into account legislative requirements, and are being applied in Commission regional and field offices. Early results of this audit have indicated the need for a complete rewrite of investigation and control procedures. This will be completed late in 1978.

Recommendations

- efforts should be made to reduce the incidence of clerical errors made by employers in the preparation of the Record of Employment forms.

Commission's Comments

Agreed. A quality control/quality assurance program specifically to reduce ROE employer errors is now being developed. This program will be implemented in 1979. Also, revisions to the ROE and instructional material for employers will be implemented in 1979.

Development of On-line Benefit Pay System

14.148 A review of the adequacy of the Agreed. financial controls being incorporated into the new on-line system should be performed by the Commission before its further implementation in other regions or district offices.

Commission's Comments

Agreed. Such a review has already been started. The On-line Benefit Pay System will not be extended before the findings of that review are evaluated.

Labour Market Policy and Immigration and Demographic Policy Groups

Purchase of Training

14.158 Federal-provincial agreements should clearly specify the basis for interim payments and this basis should be observed by all Regions in making such payments.

Commission's Comments

Agreed.

14.162 The federal-provincial agreements should continue to make provision for the timely certification of costs. The Commission should pursue with the provinces the possibility of amending the federal-provincial agreements so as to provide for alternate procedures should the certifications not be forthcoming.

Commission's Comments

Agreed. The Commission agrees with the recommendation that the agreements should continue to make provision for timely certification of costs and has included such a requirement in the agreements just negotiated. The Commission however considers it unnecessary to amend the agreements to provide for alternate procedures in the event that certifications are not forthcoming and will deal with individual circumstances if and when they arise through other means.

Recommendations

Training Improvement Program

14.165 A standard procedure for reviewing all Training Improvement reports should be established and a follow-up program devised, where appropriate, to ensure that the maximum benefit is derived from the reports.

Commission's Comments

This program has been cancelled effective in 1979-80.

Recommendations

Canada Works Program

14.169 The Commission should review the way in which Canada Works program funds are being used, develop clearer guidelines and ensure that program criteria are observed.

Commission's Comments

The situation is constantly under review and guidelines are re-written each program year to ensure clarity and firmness.

Recommendations

Other Operating Expenditures

14.172 Although the Treasury Board approved these submissions, we believe that the Commission should follow the Government Contracts Regulations and invite competitive tenders for advertising contracts.

Commission's Comments

The Commission will abide by Treasury Board requirements.

Recommendations

Improperly Drafted Agreements

14.176 Standard agreements for all contribution programs should contain clauses to ensure that collection of overpayments can be pursued.

Commission's Comments

Agreed. Arrangements are now being carried out to formalize the practice recommended for all contribution programs.

1978 Report of the Auditor General of Canada - Chapter 15

```
<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Department of Communications</H1>
</CENTER>
<IMG SRC="../../graphics/linegra3.gif" WIDTH=100% ALT="line">
<HR>
```

Summary of Findings, Observations and Recommendations

Introduction

Departmental Overview

15.1 The Department of Communications was established in 1969 by the Department of Communications Act, R.S., c. C-24.

15.2 The Department's objective is to foster the orderly development and operation of communications for Canada in the domestic and international spheres. Its responsibilities within Canada consist of the extension of existing telecommunications systems and services; the development and introduction of new communications systems, facilities and resources; the management of the radio frequency spectrum to permit the development and growth of radio communications; and the development of telecommunications services for the Government of Canada.

15.3 Internationally, the Department's responsibilities involve protecting and supporting Canadian interests in international telecommunications systems, services and undertakings.

15.4 The Department is organized into four main sectors, Policy, Space Program, Research, and Services, each headed by an Assistant Deputy Minister. Its field operations are carried out through five regional and 44 district offices. Exhibit 15.1 illustrates the departmental structure including the functions for which each Assistant Deputy Minister is responsible.

Exhibit not available

15.5 The Department operates within a highly technical and evolving field. It includes the Government Telecommunications Agency Revolving Fund, which is responsible for planning, establishing and managing telecommunication facilities and services to meet the needs of federal departments and agencies in the most cost-effective manner.

15.6 At March 31, 1978, the Minister held voting rights of 49.99% of the issued and outstanding shares of Telesat Canada, which are reflected in the financial statements of Canada at their cost of \$30 million. In addition, Teleglobe Canada was indebted to the Department for \$23.6 million for advances made for capital expenditures.

15.7 In fiscal year 1977-78, the Department's budgeted gross expenditures were \$86.7 million and its authorized man-years were approximately 1,900. The following is a summary of the Department's financial operations for the 1977-78 fiscal year.

Summary of Financial Operations

(in millions of dollars)

Department:

Operations	\$ 69.1
Capital 6.7	
Grants, contributions and other transfer payments	<u>2.6</u>
Total gross expenditures	78.4
Less: Receipts and revenues (including those credited to the Vote)	<u>15.7</u>
	<u>\$ 62.7</u>

Government Telecommunications Agency

Revolving Fund:

Operations	\$ 36.0
Engineering support	3.0
Administration	<u>1.3</u>
	<u>\$ 40.3</u>

Summary of Audit Office Activities

15.8 As described in the main body of our Report, the Office of the Auditor General has developed a comprehensive audit approach which provides for an examination of all major programs and responsibility centres within the Department on a cyclical basis.

15.9 The current year's examination included the following:

- a review of the organization and role of the financial function within the Department;
- Studies of Procedures in Cost Effectiveness (SPICE) related to the:
 - Radio Frequency Spectrum Program
 - Government Telecommunications Agency
- a review of the internal audit function;
- a study of contracting; and
- a review of the financial control systems and tests of transactions in most of the major areas of the Department and of the Government Telecommunications Agency.

15.10 Following completion of each segment of the examination, a report outlining our findings and recommendations was issued to the Department. This Chapter includes a summary of the most significant of these findings, but does not include all items reported on in the individual reports.

15.11 In general, we found that the Department has demonstrated an awareness of the importance and need for strong financial management and control, as evidenced by the proposed plan of organization for the financial function, discussed in the next section of this Chapter, and the fact that the Department has implemented practically all the recommendations made in previous years' Reports.

15.12 Although we did not find major weaknesses or deficiencies in this year's examination of the financial operations, we believe there is room for considerable improvement in certain aspects of the Department's operations. The most important of these are discussed in the remainder of this Chapter.

15.13 We wish to express our appreciation for the co-operation and assistance extended to us by the Department's personnel during our examination.

Organization and Role of the Financial Function

Background

15.14 Because of its importance in providing a proper framework for an effective financial management and control system, the Audit Office has been devoting considerable attention to assessing the soundness of a department's financial organizational structure. Accordingly, our examination included an assessment of the organization of the financial function proposed within the Department in the 1977-78 fiscal year. The chart illustrated in Exhibit 15.2 summarizes the proposed plan of organization.

Exhibit not available

15.15 We understand that the proposed plan has been approved in principle at the Assistant Deputy Minister level, but that the Deputy Minister has requested that it be evaluated by a third party. Since the proposed organizational arrangements have yet to be approved and implemented, an evaluation of their effectiveness at this time would be premature and inappropriate. Consequently, our efforts were concentrated on determining the extent to which the plan meets the criteria that are normally used in this type of assessment.

15.16 Among the more important of these criteria are the following:

- the degree of involvement of senior financial personnel in the departmental decision-making process;
- the appropriateness of the role senior financial personnel play in advising and assisting senior program personnel on all aspects of the financial management and control function, including the preparation of Program Forecasts and Estimates;
- the extent to which senior program personnel understand their financial management responsibilities and the adequacy of the methods that exist for familiarizing new personnel with their responsibilities in this regard;
- the acceptance by both senior financial and program personnel of the senior financial officer's mandate for ensuring that adequate financial controls exist within all financial systems, including those that are not his direct responsibility;
- the adequacy of staffing arrangements as they relate to financial positions, including the selection, training and evaluation of financial personnel; and
- the adequacy of the functional guidance given by senior financial officers to financial personnel outside their respective jurisdictions and the mechanisms that exist for this purpose.

Scope of Review

15.17 Our study consisted of reviewing the organizational arrangements in the draft memorandum on "Organizational Structure of Financial Management", the draft brochure entitled "Organization Manual - Finance Branch" dated February 1978 and the job descriptions of certain key financial positions. We also interviewed a number of people at Headquarters and in one regional office.

General Assessment

15.18 In general, the proposed plan indicates the Department recognizes the importance of financial management and control and the way in which the financial function should be organized and carried out. It is our opinion however, that two basic areas within the proposed organizational arrangements require further attention. These are outlined below.

Observations and Recommendations

15.19 Responsibilities for financial management and control. The Assistant Deputy Minister (Services) (ADM(S)) has been designated as the senior financial officer. The financial function is one of seven for which the Assistant Deputy Minister (Services) is responsible, in addition to the Department's field operations. Because of the extensive and diverse nature of these responsibilities, the danger exists that adequate time and attention may not be devoted to finance despite the designation of the Director General, Finance as the senior full-time financial officer. Moreover, the combination of finance with other non-financial responsibilities may lead managers of the organization to perceive the role of finance as one of service only, and they may not give adequate attention to communicated concerns over control weaknesses. However, the senior financial officer should continue reporting directly to the deputy head and be a member of the senior management committee. The Department has taken action in this regard.

15.20 *The financial function should be the main responsibility and concern of the Senior Financial Officer.*

15.21 Functional responsibilities. The description of the Senior Financial Officer's role indicates that the Assistant Deputy Minister (Services) is expected to give functional direction to responsibility centre managers on all financial matters, including organization and staffing of the financial function, both at Headquarters and in the regions. Such responsibilities entail the direct involvement of the individual carrying out this role in the detailed financial administration of the Department. Owing to the present workload of the Senior Financial Officer (ADM(S)), such responsibilities have been delegated to the Director General, Finance.

15.22 The Department recently established financial officer or adviser positions within programs and regional offices but only some have been staffed. Job descriptions do not clearly define the functional relationships of these positions with headquarters financial personnel. Although in some cases these functional relationships have been developed in an informal manner, there is a need to have them documented and communicated throughout the Department.

15.23 *Functional responsibilities and relationships should be clearly defined, documented and communicated within the Department.*

15.24 The implementation of the above recommendations in conjunction with the proposed plan of organization would result in a financial organization that can function effectively.

Studies of Procedures in Cost Effectiveness

Introduction

15.25 These studies are two of a series from the Auditor General's Study of Procedures in Cost Effectiveness (SPICE), a project designed to explore and develop the concept of value-for-money audits. The sections which follow contain the principal findings and recommendations of special studies of the Radio Frequency Spectrum Program and the Government Telecommunications Agency.

15.26 Throughout the audits of these programs, emphasis was placed on the systems and procedures the Department used to achieve economy, efficiency and effectiveness in its operations. The focus was on how managers controlled the operation of the programs and evaluated their effectiveness.

Radio Frequency Spectrum Program

Background

15.27 The Radio Frequency Spectrum Program is intended to improve and extend the use of the radio frequency spectrum to permit the development and growth of radio Communication. Plans for 1977-78 called for 1,056 man-years and expenditures of approximately \$24 million.

Scope of Review

15.28 Our review of the Program consisted of examining major management functions at Headquarters and activities involving the authorization of spectrum users and the enforcement of regulations, carried out at 44 district offices across five regions.

General Assessment

15.29 Management controls were ineffectual in providing assurance that the Program was achieving its objectives or was being carried out in an economic and efficient manner.

15.30 Regional autonomy had been carried beyond reasonable bounds. Some regions had paid meagre attention to important concerns communicated by Headquarters and some technical systems and procedures were ignored. Levels of service to the public were inconsistent across the country in terms of quality and timeliness and had not been satisfactorily cost-justified.

15.31 Within Headquarters, the development of radio regulations was inadequately co-ordinated and controlled. Procedures had not been established regarding cost recovery for services provided to the public. A major computer-based development program, estimated to cost \$10 million, had been undertaken but lacked commensurate management controls. The presentation of performance measurement data in the Program Forecasts was confusing and subject to misinterpretation.

15.32 A number of the shortcomings reported on were being addressed by management before our audit. During the audit, senior management responded promptly to our initial findings.

Observations and Recommendations

15.33 Program planning system. The Department has been developing and improving its planning system during the last few years. There are still, however, a number of major opportunities for improvement.

15.34 We examined the planning systems in two regions and found there were no standard definitions and production times for Program tasks. For instance, the production time allowed to complete similarly described inspections differed between these regions by as much as 300%. In addition, there were no national guidelines for the service levels provided to the public and, as a result, they differed among the regions. The Department had recognized both of these problem areas at the time of our audit and corrective action was being initiated.

15.35 The Department has not considered fully the costs and benefits of alternative methods of enforcement to those now being followed in the regions. For example, in Canada 430 man-years were allocated in 1976-77 for regional enforcement and monitoring activities. In the United States, 486 man-years were allocated for similar but not identical Spectrum management field operations. An examination of United States' practices might alert the Department to opportunities for enhancing the economy of the enforcement function.

15.36 The Department should continue to develop standard definitions and, where appropriate, production times for Spectrum tasks. It should refine the guidelines for service levels provided to the public and evaluate the costs and benefits of alternative methods of enforcement.

15.37 Performance measurement system. The Department has used its performance measurement system to support Program Forecasts since the 1975-76 Forecast.

15.38 Our examination of the supporting data raised questions about the validity of these data. For example, some outputs were forecast but corresponding actuals were not reported; those outputs which were both forecast and reported to our questions we were unable to satisfy ourselves about the validity of the performance data presented. Since the time of the audit, the Department has been taking steps to correct the situation.

15.39 The Department should take appropriate steps to ensure that meaningful and accurate performance measurement data are used for Program Forecasts and control purposes.

15.40 Program evaluation. The Program's stated objective is to improve and extend use of the radio frequency spectrum, to permit the development and growth of radio communications. The Department interprets this objective to mean increasing the opportunities for use of the spectrum and effectiveness could be measured in these terms. Present performance indicators, such as the number of applications processed, the number of inspections carried out and other statistical data, are measures of operational effectiveness which could serve as useful proxies for program effectiveness. More direct measures of program effectiveness might be difficult to develop.

15.41 The Department should continue to develop and refine its regional reporting system to ensure the provision of timely, relevant and accurate data to measure operational effectiveness. These measures should be used as proxies to indicate program effectiveness.

15.42 Regulations development. Regulations governing use of the radio frequency spectrum are essential for the Program to achieve its objective. These regulations form the basis for more detailed standards, procedures and practices which guide radio inspectors as they carry out their authorization,

enforcement and monitoring activities. Therefore, regulations are a cornerstone of the Spectrum Program.

15.43 The Department's procedures for planning and controlling regulation development, however, were inadequate. At the time of our review, nearly half of the regulations under development had no scheduled completion dates; of the remainder, many were several months behind schedule; regulations that did not reflect program priorities were under development; and unnecessary delays had occurred due to poor coordination procedures.

15.44 *The Department should designate a senior official to authorize and monitor regulation development in accordance with program priorities and should establish a project management system to control this activity.*

15.45 Technical and Operating systems. As a result of growing spectrum use, it has become increasingly important that regions use standard technical systems and effective operating procedures. In some aspects of technical systems and operating procedures, Headquarters has not provided adequate direction to the regions. In other areas, the regions have failed to adopt routines developed by Headquarters. As a result, the introduction of certain technical systems has been slow, development effort has been duplicated and non-standard routines are used in the regions.

15.46 *The Department should:*

- *assign to a specific Headquarters group the responsibility for approving and co-ordinating the continuing development of technical systems;*
- *establish and maintain more effective operating procedures; and*
- *ensure that all regions adopt standard technical systems and operating procedures.*

15.47 Control of special projects. In 1974, the Department established the Information System Steering Committee to advise the Deputy Minister on information systems, including computer-based development projects. The Committee authorizes and monitors their development on his behalf. Despite this, a major computer-based project was marked by a lack of planning and control from its outset in 1974. This project, called the Spectrum Management System, was approved by the Treasury Board in 1975 with an estimated cost of about \$10 million and completion scheduled for 1980.

15.48 In early 1976, management made significant improvements in defining, organizing and planning the project. Our audit in early 1977, however, disclosed additional planning and control deficiencies. For example, a key module of the project requires that all regions collect technical and operating data on existing stations. Widely differing data collection approaches were being used in the regions without Headquarters evaluation of the costs and benefits of the approaches or assessment of the validity and comparability of the collected data. When this deficiency and others were pointed out to management, a major review of the project was begun.

15.49 *The Department should establish standard procedures, based on Treasury Board guidelines, for planning a project and monitoring its progress. Project plans should include regular review by the Information System Steering Committee.*

15.50 Cost recovery practices. The Radio Frequency Spectrum Program charges the public for certain of its services. These services are primarily of a licensing nature, but also include activities such as the

supervision of certain types of radio operator examinations, the conduct of ship radio inspections and the laboratory testing of radio equipment.

15.51 Until 1971, the Department fully recovered the Spectrum Program's costs. Since that time, the Program has operated with significant annual deficits. To improve this situation, a fee increase of 30% was applied to all licence categories in April 1975; however, the deficit still amounted to \$2.7 million for 1976-77. Since 1976, fees for services provided by the Program have been under review. A February 1977 departmental draft report on the revision of licence fee schedules pointed out that substantial deficits would continue unless fees were extensively revised. During our audit there was no indication when a revised fee schedule would go into effect.

15.52 *The Department should update its fee structures periodically, with a view to recovering full service costs.*

Government Telecommunications Agency

Background

15.53 The Agency provides voice, data and facsimile transmission services to users through the bulk leasing of facilities at reduced costs. It operates on a revolving fund basis and recovers the full cost of its services through charges to user departments and agencies.

Scope of Review

15.54 Our review consisted of examining the operation of the intercity voice network, which is a major activity of the Agency, operating at an annual cost of approximately \$24 million. The examination focused on the concept of grade of service as it relates to the provision of intercity telephone circuits. Grade of service is a technical term used by the telecommunications industry. It measures the probability that a call offered to an intercity circuit group at the busiest hour will be denied service. The study also developed a program model to examine the extent to which the Agency's program is structured to permit evaluation of effectiveness.

General Assessment

15.55 Controls affecting the management of the government intercity telephone service need to be improved. Better network management could be achieved if a clear rationale were used to develop grade of service guidelines for circuit utilization and if the provision of circuits were closely monitored against these guidelines. Improved traffic information is needed to assist in setting the guidelines and in determining the number of circuits to be provided. In addition, formal policies and procedures with respect to the provision of individual circuits are inadequate and there is insufficient documentation of decisions taken. The monthly traffic report intended to measure and evaluate network performance is not achieving its purpose.

15.56 Two other areas where value-for-money issues have been identified are the reduction of commercial long distance use in the federal public service and the joint procurement of telephone circuits with other major government users.

15.57 There is a constraint on the ability of the Agency to plan and coordinate telecommunications services in the government adequately in accordance with the Department of Communications Act.

This has been imposed by the Treasury Board approved program objective, which restricts the Agency to responding only to requested user needs; that is, "to plan, establish, and manage telecommunication facilities and services that will satisfy the requested needs of federal departments and agencies on an economic basis." It is likely that there are additional benefits which would accrue to the Government if the approved program objective of the Agency were enlarged to permit it to exercise the mandate set out in the Act.

Observations and Recommendations

15.58 Grade of service. Effective management of the Agency's network requires that grade of service guidelines be set and used in a more meaningful manner. No documentation could be found to explain the rationale for the selection of grade of service guidelines for network utilization nor have they been approved by the Treasury Board as required. No attempt is made to monitor the performance of the network against these guidelines. The same grade of service guidelines are also used in determining the number of circuits to provide to individual circuit groups, and are inadequate for this purpose, particularly in the case of smaller groups.

15.59 *The Agency should:*

- *re-examine the grade of service guidelines for the intercity network. These guidelines should then be submitted for approval to the Treasury Board Secretariat in accordance with the Directive set out in the Guide on Telecommunications Administration; and*
- *determine grade of service guidelines for individual circuit groups and monitor actual performance according to established permissible variances, taking into account traffic variations and the characteristics of each circuit group.*

15.60 Traffic information. Improved traffic information is needed to assist in setting grade of service objectives. Information on actual traffic carried on the network is also required to monitor performance and to provide the circuits required to meet established objectives. The limited traffic information data base currently used by the Agency is not adequate for these purposes.

15.61 In addition, formal policies, procedures and records regarding the provision of circuits to individual circuit groups are inadequate and there is insufficient documentation of decisions taken.

15.62 The monthly traffic report, intended to measure and evaluate network performance, is not achieving its purpose owing to deficiencies in grade of service and traffic information it contains. For example, it does not indicate permissible variances in grade of service and the traffic volumes reported lack reliability. Moreover, the report does not incorporate circuit cost information and is not available until up to 10 weeks after the end of the month under review.

15.63 *The Agency should:*

- *determine the feasibility of obtaining more timely and comprehensive traffic data information on a cost-effective basis;*
- *establish formal policies, procedures and records to govern the provision of circuits to individual circuit groups; and*

- *improve the timing and effectiveness of monthly traffic reports. The reports and the computer program for producing them should be modified to indicate the costs associated with variations from established grade of service objectives or with changes in these objectives.*

15.64 Commercial long distance traffic. Commercial long distance traffic, which could be carried on the Agency's network but is not, is called parallel traffic. The Agency estimates that total annual government expenditures on this traffic are approximately \$2 million.

15.65 At present, the Agency has only limited knowledge of commercial long distance use by individual Federal Government departments and agencies. Greater information on the extent of this use would contribute to more effective management of the intercity network. Departments and agencies could then be informed by the Agency of the extent of their parallel traffic.

15.66 *The Agency, with the collaboration of the Treasury Board, user departments and agencies and the telephone companies, should obtain additional information on commercial long distance use. It could then assist departments and agencies in determining the extent of their parallel commercial long distance calls and the savings to be achieved through the use of its facilities.*

15.67 Common Telpak procurement. Special rate arrangements known as Telpaks offer significant savings through the bulk leasing of long distance circuits. A number of departments and agencies lease circuits independently of the Agency under separate Telpak arrangements. The Agency has stated that significant savings would be available to the Federal Government through common Telpak procurement for all major users.

15.68 The Guide on Telecommunications Administration, which was prepared by the Treasury Board Secretariat, assigns a central role to the Agency in coordinating procurement of telecommunications for the Federal Government.

15.69 *The Agency, with the collaboration of other major users, the Department of Supply and Services and the Treasury Board Secretariat, should determine the savings to be realized through common Telpak procurement. Steps should be taken to ensure that the savings are realized to the maximum extent practicable.*

15.70 Program evaluation. The Agency may respond only to requested user needs under the program objective the Treasury Board approved -- "to plan, establish, and manage telecommunication facilities and, services that will satisfy the requested needs of federal departments and agencies on an economic basis." This restriction permits the Agency to respond only to "requested needs", posing a major constraint on its ability to carry out the planning and coordinating role anticipated for it under the Department of Communications Act. It is likely that additional benefits would accrue to the Government if the approved program objective of the Agency were enlarged to permit it to exercise the mandate set out in the Act. Until such time as the program objective reflects the Agency's mandate, there will be uncertainty about the particular performance indicators to be used to reflect program effectiveness.

15.71 *The Department should accelerate negotiations with the Treasury Board with a view to expanding the Agency's program objective to reflect the mandate set out in the Department of Communications Act. These negotiations should be supported by estimates of the benefits lost to the Government because of the present mandate restrictions.*

Review of Internal Audit Function

Background

15.72 The internal audit function is the responsibility of the Program Evaluation Group. A composite audit approach, which includes both operational and financial audits, was adopted in the 1976-77 fiscal year and the Department was one of the first departments of government to do so. This approach was incorporated into the Program Evaluation Group's overall audit plan, which spanned a period of five years and which provided for audits of the financial administration system at least once every three years.

15.73 Because of a lack of internal resources, the Department contracted for the services of the Audit Services Bureau of the Department of Supply and Services to assist the Program Evaluation Group in carrying out its audit function. The cost of the internal audit function for the 1977-78 fiscal year was estimated at \$450,000, of which \$310,000 was for the services of the Audit Services Bureau.

Scope of Review

15.74 The main objectives of our review of this function were to determine whether the Department was receiving good value from its internal audit activities and whether such activities could affect the nature, timing and extent of auditing to be carried out by this Office.

15.75 Our examination included interviews with senior managers and staff directly involved with the internal audit function, a review of the audit mandate, and an examination of the reports and supporting working papers related to the audits of the:

- Telecommunications Regulatory Service - Operations Branch
- Government Telecommunications Agency

General Assessment

15.76 The result of our examination led us to conclude that:

- although we believe that sound recommendations have been made in certain cases by the Program Evaluation Group, in other cases we were not able to find sufficient evidence in the working papers to satisfy ourselves that all important control weaknesses had been identified and that the conclusions reached by the Group in its audit reports were valid; and
- because the Program Evaluation Group is still in its developmental stage and its efforts to date have been concentrated primarily on operational rather than financial audits, the work performed by this Group cannot materially influence the nature, timing and extent of the audit carried out by this Office.

Observations and Recommendations

15.77 Audit committee. Although no formal audit committee exists, the Senior Management Committee, comprising the Deputy Minister and the four Assistant Deputy Ministers, review and discuss audit reports, including the responses to them. The Director -- Program Evaluation Group is invited to attend meetings called for reviewing audit reports and other audit matters. Minutes of Senior Management Committee meetings are not kept. We were informed that decisions thought to be of

interest to the Program Evaluation Group were forwarded to its Director. However, since there are no written minutes there is no assurance that the Committee forwards all decisions that could interest or assist him.

15.78 An official audit committee with specific terms of reference should be established to ensure continuity of the audit function, provide guidance to the audit group and, ensure that appropriate action is taken on audit findings. The Director -- Program Evaluation Group should attend all meetings of the audit committee and minutes of the committee's meetings should be kept to provide a record of the items discussed and decisions made.

15.79 Mandate. The Program Evaluation Group's mandate does not place sufficient emphasis on evaluating the financial controls required to ensure the Department's assets are adequately safeguarded; nor does it refer to unrestricted access to files, documents, information, etc., and unrestricted scope and coverage for audits. Moreover, this document is not circulated throughout the Department to provide for a clear understanding of the role of the internal audit function and its importance.

15.80 The mandate of the Program Evaluation Group should be clarified and widely distributed, to demonstrate visible support of the audit function by the senior executives of the Department.

15.81 Audit group. The Director -- Program Evaluation Group reports to the Assistant Deputy Minister (Services) who is responsible for a number of the functions that are subject to audit. This reporting relationship does not provide the internal audit function with the independence it requires. We understand that a direct reporting relationship to the Deputy Minister has now been established.

15.82 The Program Evaluation Group should be organizationally independent of all operations which they audit and report directly to the Deputy Minister.

15.83 Direction. Although its mandate clearly states that it is responsible for the internal audit function, the Program Evaluation Group has delegated responsibility for the professional performance and quality of the composite audit to the Audit Services Bureau. Moreover, audit programs and working papers remain the property of the Audit Services Bureau and audit reports are issued under their letterhead. We were informed however, that the Director -- Program Evaluation Group is responsible for the final review of any report to be issued.

15.84 The Program Evaluation Group should be responsible for the scope and quality of all auditing work carried out for the Department, including that done under contract by the Audit Services Bureau.

15.85 Audit coverage. There is no assurance that the Program Evaluation Group will be able to cover all responsibility centres within the three-to-five year time frame originally planned, including financial audits as recommended by the Treasury Board. This is due both to a lack of resources and the fact that completion of audit assignments and debriefing process take more time than anticipated. The scope of the audit approach used, which consists of an all-inclusive review of a sector or responsibility centre and which reduces the depth to which audits are carried out, further aggravates this situation.

15.86 Areas for audit should be selected on the basis of identified priorities within the overall plan. Audit scopes should then be determined considering, among other things, identified concerns, potential benefits, management priorities and resources available. In particular, care should be taken to ensure that sufficient attention is paid to financial audits.

15.87 Working papers. Our examination of selected audit files revealed a lack of proper documentation, making it impossible to determine whether all important control weaknesses had been identified the manner in which these files were organized, and information documented and assembled, did not provide the evidence required to substantiate the conclusions reached as to the adequacy or inadequacy of controls.

15.88 *Working papers should provide evidence that audit objectives are complied with, approved audit methods and procedures are followed, and applicable audit standards are adhered to.*

15.89 Follow-up While follow-up reports produced to date appear adequate, we believe the employee now responsible for following up on audit findings lacks the qualifications or experience required to carry out the duties as described in the position description. The need for strong follow-up procedures is evident since they are an integral part of the audit function.

15.90 *Follow-up audit procedures should be performed by audit personnel with the knowledge, discipline and skills necessary to carry out this responsibility.*

Study of Contracting

Background

15.91 A special study of the practices followed across government on the entry into and administration of contracts was initiated in 1976. Treasury Board policies and guidelines and a departmental directive issued in March 1976, regulate contract administration in the Department. The latter designated a Contract Review Board as the departmental authority for approving contracts originating within the Department. The Deputy Minister and Assistant Deputy Ministers and the Directors General of Personnel and Administration and of Finance make up the Contract Review Board.

Scope of Study

15.92 A study of contracting procedures and administration within the Department was conducted during the 1976-77 and 1977-78 fiscal years. Forty-four contracts totalling \$2.8 million were examined to evaluate the effectiveness and adequacy of contracting procedures and controls.

General Assessment

15.93 In general, our study did not reveal major weaknesses in laid-down procedures and controls. The deficiencies noted were the result of non-adherence to these procedures and controls as well as a lack of direction in the departmental directive on contract administration. The deficiencies have been communicated to the Department and steps were taken to resolve the weaknesses.

Observations and Recommendations

15.94 Financial signing authority. Before entering into a contract, commitment certification pursuant to Section 25 of the Financial Administration Act and authority to initiate an expenditure are required from authorized officers. We noted that for computer services this type of authority was being exercised by departmental officers who were not all authorized to do so.

15.95 *Financial signing authority, as it relates to requisitions for computer services, should be exercised only by officers with appropriate delegated authority and it should be the responsibility of the Accounting Services section to ensure that this is the case.*

15.96 Administration of contract requests. A departmental directive sets out the procedures for processing contract requests, including Contract Review Board approval and completion of departmental checklists.

15.97 Departmental requirements for electronic data processing services are being referred to Computer Services, but are not being presented to the Contract Review Board for approval and departmental checklists are not being completed. Furthermore, the departmental directive does not provide direction relative to processing amendments to contracts.

15.98 *Contract proposals for electronic data processing services should be referred to the Contract Review Board for approval and the checklists called for by departmental policy should be completed.*

15.99 *The departmental directive should provide direction for the processing of amendments to contracts.*

15.100 Sole source selection. The Treasury Board Policy and Guidelines on Contracting in the Government of Canada provide for allocating responsibility between client departments and common service agencies when calling for tenders. They specify that "the overall contracting phase" is the primary responsibility of a common service agency. The Policy and Guidelines state the circumstances and conditions under which departments may request entry into sole source procurement. In a few instances, departmental requests did not duly record justification or properly justify sole source procurement in accordance with the Treasury Board Policy and Guidelines.

15.101 *All sole source procurement contract requests should be properly justified and such justifications recorded.*

Examination of Financial Operations

Scope of Audit Activities

15.102 The Office employed a systems-based audit approach to examine the financial operations of the Department and of the Government Telecommunications Agency. This examination included a review of the financial control systems and tests of transactions in most of the major areas of the Department and of the Agency. In particular, the examination covered:

- the receipt and deposit of public money, materiel management, and grants and contributions;
- the receipts and revenue credited to the vote and the control over expenditures, fixed assets and inventories of the Communications Research Centre;
- revenues for a number of district offices as well as the information provided for inclusion in the Accounts of the Government of Canada by all regional offices; and

- financial controls within the Government Telecommunications Agency, including sufficient audit tests to enable the Auditor General to express an opinion on the financial statements of the Agency.

15.103 *The audit procedures performed were designed to assess the adequacy of the systems in place and to satisfy ourselves that there were no material irregularities or errors or both, which could affect the Auditor General's opinion on the financial statements of Canada as well as on those of the Agency. The audit procedures were also designed to determine whether moneys due to Canada were received and fully accounted for, moneys expended were for the purposes for which they were appropriated by Parliament and expenditures had been made as authorized. Our major findings are set out in the paragraphs that follow.*

Observations and Recommendations - Department

15.104 Fixed assets and inventories. We found that control over the Research Centre's fixed assets and inventories was seriously inadequate. For example, subsidiary records kept by certain responsibility centres were out of date and, in some cases, practically non-existent. Fixed assets were not properly identified and certain items sent for repair, approximately two years ago, had not been returned or recorded as having been returned. Moreover, in certain cases, physical counts have not been taken for over three years and are not always carried out when there is a change in inventory custodian.

15.105 *Proper controls over fixed assets and inventories, as recommended by the Treasury Board's Guide on Financial Administration, should be established to ensure that the Communications Research Centre's assets are adequately safeguarded.*

15.106 Research services. In certain cases, the Centre performs research services for the private sector. An internal directive requires that requests for such services be approved by the Assistant Deputy Minister, Research. Furthermore, in accordance with section 13 of the Financial Administration Act, the rates to be charged for such services are the responsibility of the Governor in Council. Our examination revealed that requests for such services are not approved and that Governor in Council authorization has not been obtained for the rates charged.

15.107 *The Centre's directive on private sector requests for research services should be strictly adhered to and approval of the rates to be charged for such services should be obtained from the Governor in Council.*

15.108 Segregation of duties. The 44 district offices collect annual revenue of approximately \$10 million, consisting mainly of licence fees. During our examination, we noted that in certain cases the same individual is responsible for the custody, processing and issuance of licences as well as control over cash receipts. We recognize that the majority of these offices are small and consequently, a proper segregation of duties is difficult to establish. We believe that it is important, however, that more effective control be established over cash receipts.

15.109 *In order to strengthen control over the Department's revenues, the cash receiving function should be segregated from other related functions. Alternatively, in cases where such segregation is not practical, the district manager should perform and document periodic spot checks of the operations.*

15.110 Payroll. Attendance reports are completed on an exception basis only; that is, if an employee is not absent during a month, a report is not made to the Personnel section. Thus, there is no way to ensure that all employee absences have been properly accounted for.

15.111 *Attendance reports should be prepared monthly for every employee.*

Observations and Recommendations - Government Telecommunications Agency

15.112 As was the case in prior years, our current examination has revealed a number of weaknesses in the Agency's financial systems, controls and procedures. In our opinion, many resulted from a lack of sufficient and proper attention devoted to financial aspects. The more significant of these are discussed below.

15.113 Accounts receivable system. Since the Agency operates on a full cost-recovery basis, it invoices client departments and agencies monthly for services rendered. Until June 1977, the preparation of over 3,000 invoices monthly was done manually. Since then, the invoicing function has been computerized. The subsidiary ledger for these accounts receivable, however, is still a voluminous ledger to which entries are recorded with a bookkeeping machine. This results in delays in the posting of information and inefficient and uneconomical preparation of periodic management reports.

15.114 *To ensure the maintenance of an accurate, efficient and economical accounts receivable system, the Agency should take the steps required to establish a fully computerized accounts receivable subsidiary ledger.*

15.115 Systems documentation. The documentation of systems and procedures within an organization enables management to hold personnel accountable for following prescribed procedures, facilitates the indoctrination of new staff, ensures uniformity where procedures are used in a number of offices, etc.

15.116 We noted that the Agency has no systems documentation standards and that documentation related to the invoicing and collection system is incomplete and outdated and does not include details of manual procedures performed in related user management areas of responsibility. We understand that a plan was approved in May 1978 whereby the first draft of items peculiar to the Agency would be incorporated in a completely revised departmental financial administration manual in 1978-79.

15.117 *We support the plan to document systems and procedures peculiar to the Agency Once such documentation has been established, it should be maintained on a current basis.*

15.118 Financial function. In our 1976 management letter we recommended that a financial division be established within the Agency with line responsibility to the General Manager of the Agency and functional responsibility to the Director General, Finance, of the Department. As at March 31, 1978, an organizational plan had been approved; however, the Finance Division was not yet operational

Follow-up on Previous Years' Recommendations

5.119 Introduction. As part of its regular audit activities, the Office follows up on any remedial action taken by government departments on observations and recommendations in previous annual Reports.

15.120 The Office was pleased to note that the Department and Agency had implemented corrective measures with respect to all but one of the observations previously reported to Parliament. The

observation on which corrective action has not yet been taken as at March 31, 1978, is discussed below.

15.121 Termination benefits and vacation pay. As at March 31, 1978, the Agency had not recorded in its accounts, liabilities for employee termination benefits and accumulated vacation pay) amounting to \$321,000 and \$106,000 respectively.

Summary of Recommendations and Department's Comments

Recommendations

Organization and Role of the Financial Function

15.20 The financial function should be the main responsibility and concern of the Senior Financial Officer.

Department's Comments

The Department is in the process of defining the roles and responsibilities of the Senior Financial Officer in consultation with the Office of the Comptroller General and the Treasury Board Secretariat.

Recommendations

15.23 Functional responsibilities and relationships should be clearly defined, documented and communicated within the Department.

Department's Comments

The functional responsibilities and relationships have been defined and documented and reviewed by the Office of the Auditor General in the draft memorandum, "Organizational Structure of Financial Management". This document is being considered prior to approval and issue.

Studies of Procedures in Cost Effectiveness

Radio Frequency Spectrum Program

Recommendations

15.36 The Department should continue to develop standard definitions and, where appropriate, production times for Spectrum tasks. It should refine the guidelines for service levels provided to the public and evaluate the costs and benefits of alternative methods of enforcement.

Department's Comments

This is being done on an ongoing basis.

Recommendations

15.39 The Department should take appropriate steps to ensure that meaningful and accurate performance measurement data are used for Program Forecasts and control purposes.

Department's Comments

The procedures to ensure data integrity are being upgraded.

Recommendations

15.41 The Department should continue to develop and refine its regional reporting system to ensure the provision of timely, relevant and accurate data to measure operational effectiveness. These measures should be used as proxies to indicate program effectiveness.

Department's Comments

A Management Information System is being implemented that will provide this data.

Recommendations

15.44 The Department should designate a senior official to authorize and monitor regulation development in accordance with program priorities and should establish a project management system to control this activity.

Department's Comments

Director, Regulation Development in the Telecommunication Regulatory Service has been appointed and has been given this mandate.

Recommendations

15.46 The Department should:

- assign to a specific Headquarters group the responsibility for approving and coordinating the Continuing development of technical systems;

Department's Comments

The Telecommunication Regulatory Service has been assigned this responsibility.

Recommendations

- establish and maintain more effective operating procedures; and

Department's Comments

This is being done.

Recommendations

- ensure that all regions adopt standard technical systems and Operating procedures.

Department's Comments

This has been done on an ongoing basis.

Recommendations

15.49 The Department should establish standard procedures, based on Treasury Board guidelines, for planning a project and monitoring its progress. Project plans should include regular review by the Information System Steering Committee.

Department's Comments

The area has been further strengthened since the time of the audit.

Recommendations

15.52 The Department should update its fee structures periodically, with a view to recovering full service costs.

Department's Comments

This has been done. A cost recoverable fee schedule has been approved and is being implemented for fiscal year 1979-80.

Recommendations

Government Telecommunications Agency

15.59 The Agency should:

- re-examine the grade of service guidelines for the inter-City network. These guidelines should then be submitted for approval to the Treasury Board Secretariat in accordance with the Directive set out in the Guide on Telecommunications Administration; and

Department's Comments

Concur. In this re-examination the Agency will also review other associated guidelines affecting total quality of service.

Recommendations

- determine grade of service guidelines for individual circuit groups and monitor actual performance according to established permissible variances, taking into account traffic variations and the characteristics of each circuit group.

Department's Comments

Concur.

Recommendations

15.63 The Agency should:

- determine the feasibility of obtaining more timely and comprehensive traffic data information on a cost-effective basis;

Department's Comments

Concur. A study is under way in the Agency to determine the feasibility and cost/benefits of improving traffic reports both by TCTS and from data produced by traffic analyzing equipment used by the Agency.

Recommendations

- establish formal Policies, procedures and records to govern the provision of circuits to individual circuit groups; and

Department's Comments

Resources are being assigned to undertake the documentation of policies, procedures, and records used in processing circuit groups.

Recommendations

- improve the timing and effectiveness of monthly traffic reports. The reports and the computer program for producing them should be modified to indicate the costs associated with variations from established grade of service objectives or with changes in these objectives.

Department's Comments

Concur.

Recommendations

15.66 The Agency, with the collaboration of the Treasury Board, user departments and agencies and the telephone companies, should obtain additional information on commercial long distance use. It could then assist departments and agencies in determining the extent of their parallel commercial long distance calls and the savings to be achieved through the use of its facilities.

Department's Comments

Concur. The Department is prepared to collaborate with the Treasury Board and undertake the steps necessary to realize this objective.

Recommendations

15.69 The Agency with the collaboration of other major users, the Department of Supply and Services and the Treasury Board Secretariat, should determine the savings to be realized through common Telpak procurement. Steps should be taken to ensure that the savings are realized to the maximum extent practicable.

Department's Comments

Concur. GTA has made an estimate of the savings to be realized by improved co-ordination of Telpak procurement and has initiated action with the Telecommunications Advisory Committee that resulted in establishing an interdepartmental working group to determine the steps that can be taken.

Recommendations

15.71 The Department should accelerate negotiations with the Treasury Board with a view to expanding the Agency's program objective to reflect the mandate set out in the Department of Communications Act. These negotiations should be supported by estimates of the benefits lost to the Government because of the present mandate restrictions.

Department's Comments

Concur. Based on updated estimates of benefits to the government that would be realized by an expanded mandate for GTA, the Department has undertaken to continue further negotiations with the Treasury Board to this end.

Recommendations

Review of Internal Audit Function

15.78 An official audit committee with specific terms of reference should be established to ensure continuity of the audit function, provide guidance to the audit group and, ensure that appropriate action is taken on audit findings. The Director Program Evaluation Group should attend all meetings of the audit committee and minutes of the committee's meetings should be kept to provide a record of the items discussed and decisions made.

Department's Comments

Agreed. Recommendation adopted.

Recommendations

15.80 The mandate of the Program Evaluation Group should be clarified and widely distributed, to demonstrate visible support of the audit function by the senior executives of the Department.

Department's Comments

Agreed and implemented.

Recommendations

15.82 The Program Evaluation Group should be organizationally independent of all operations which they audit and report directly to the Deputy Minister.

Department's Comments

Agreed and implemented.

Recommendations

15.84 The Program Evaluation Group should be responsible for the scope and quality of all auditing work carried out for the Department, including that done under contract by the Audit Services Bureau.

Department's Comments

Agreed. Program Evaluation Group carries full responsibility for scope, performance and quality. The contract with the Audit Services Bureau clearly indicates that the Program Evaluation Group has total authority and responsibility and carries full accountability for all audit functions in the Department.

Recommendations

15.86 Areas for audit should be selected on the basis of identified priorities within the overall plan. Audit scopes should then be determined considering, among other things, identified concerns, potential benefits, management priorities and resources available. In particular, care should be taken to ensure that sufficient attention is paid to financial audits.

Department's Comments

Agreed. Recommendation adopted.

Recommendations

15.88 Working papers should provide evidence that audit objectives are complied with, approved audit methods and procedures are followed, and applicable audit standards are adhered to.

Department's Comments

Agreed. Existing procedures have been re-enforced. Comptroller General audit standards will be fully adhered to.

Recommendations

15.90 Follow-up audit procedures should be performed by audit personnel with the knowledge, discipline and skills necessary to carry out this responsibility.

Department's Comments

Agreed. Senior auditors are always responsible for follow-up audit reports.

Recommendations

Study of Contracting

15.95 Financial signing authority, as it relates to requisitions for Computer services, should be exercised only by officers with appropriate delegated authority and it should be the responsibility of the Accounting Services section to ensure that this is the case.

Department's Comments

The Accounting Services Division is responsible to ensure that all requisitions and contracts issued by the Department have been signed by an officer with the appropriate delegated financial signing authority.

Recommendations

15.98 Contract proposals for electronic data processing services should be referred to the Contract Review Board for approval and the checklists called for by departmental policy should be completed.

Department's Comments

The departmental policy on contract administration is being revised and will include a section on electronic data processing services that will consider the audit observations.

Recommendations

15.99 The departmental directive should provide direction for the processing of amendments to contracts.

Department's Comments

The revised directive will outline the procedure for processing amendments to contracts.

Recommendations

15.101 All sole source procurement contract requests should be properly justified and such justifications recorded.

Department's Comments

The Materiel Management section ensures that sole source procurement requests are properly justified and recorded.

Recommendations

Examination of Financial Operations

15.105 Proper controls over fixed assets and inventories, as recommended by the Treasury Board's Guide on Financial Administration, should be established to ensure that the Communications Research Centre's assets are adequately safeguarded.

Department's Comments

A control system for fixed assets and inventories has been under development for the past year. Data on fixed assets and inventories are currently being input into a computer-based inventory control system to provide more effective control of assets.

Recommendations

15.107 The Centre's directive on private sector requests for research services should be strictly adhered to and approval of the rates to be charged for such services should be obtained from the Governor in Council.

Department's Comments

Requirements for approval of work requests, including delegation of authority, are currently under review. Formal procedures will be clarified and adhered to. Approval by the Governor in Council of rate structures will be sought, as necessary, to ensure compliance with statutory requirements.

Recommendations

15.109 In order to strengthen control over the Department's revenues, the cash receiving function should be segregated from other related functions. Alternatively, in cases where such segregation is not practical, the district manager should perform and document periodic spot checks of the operations.

Department's Comments

The Department is presently studying the licence revenues and receivables function. Consideration will have to be given to other means of internal control where segregation of duties is not practical in the majority of district offices.

Recommendations

15.111 Attendance reports should be prepared monthly for every employee.

Department's Comments

The Attendance reporting system has been under scrutiny for a year now, and the new policies to be promulgated by the Deputy Head will improve managerial control in this respect. (The Department of Communications is, as are other departments in the Public Service, dependent on the new Attendance, Leave and Overtime Sub-system (ALOSS) being designed by the Treasury Board Secretariat to replace existing procedures.)

Recommendations

15.114 To ensure the maintenance of an accurate, efficient and economical accounts receivable system, the Agency should take the steps required to establish a fully computerized accounts receivable subsidiary ledger.

Department's Comments

Effective October 1, 1978, action will be initiated to phase out the present obsolete system and equipment in favour of a fully computerized accounts receivable subsidiary ledger to be fully operational for fiscal year 1979-80.

Recommendations

15.117 We support the plan to document systems and procedures peculiar to the Agency. Once such documentation has been established, it should be maintained on a current basis.

Department's Comments

Action has been initiated to document the financial systems and procedures, peculiar to the Agency, in a section of the Departmental Financial Administration Manual. Target date for completion of the manual is April 30, 1979. Some delay may be encountered in the Agency portion, however, pending finalization of the Treasury Board revised policy on revolving funds.

1978 Report of the Auditor General of Canada - Chapter 16

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Department of Industry, Trade and Commerce</H1>
</CENTER>

<HR>

Summary of Findings, Observations and Recommendations

Introduction

The Department

16.1 The Department of Industry, Trade and Commerce, created in 1969 by an amalgamation of the Department of Industry and the Department of Trade and Commerce, operates under the Department of Industry, Trade and Commerce Act, R.S., c. I-11. Its main objective is to further the growth, productivity, employment opportunities and prosperity of the Canadian economy through the efficient development of Canada's manufacturing and processing industries and the expansion of trade and tourism. The Department administers the Trade-Industrial Program and Tourism Program and participates with the Departments of Agriculture and Transport in operating the Grains and Oilseeds Program. As shown in Exhibit 16.1, the Department is organized into its main program branches all of which, except for Tourism, form part of the Trade-Industrial Program.

Exhibit not available

16.2 The major Program of the Department, the Trade-Industrial Program, operates through an organizational network consisting of a Headquarters in Ottawa, 11 regional offices and 89 posts in 64 countries. The Industrial segment of the Program seeks to achieve efficient and sustained growth of production and trade of Canadian goods and services and to assist Canadian industries in adjusting to changes in the domestic and external economic environment. The International Trade Development part of the Program deals primarily with identifying ways of fostering an expansion of trade and increasing total markets for Canadian goods and services. The Program makes available a wide variety of incentive programs to Canadian companies, involving equity investment, loans, insurance and grants and contributions, to cover innovation, productivity, financing, marketing and management.

16.3 The Tourism Program is implemented by the Canadian Government Office of Tourism, which comprises a Headquarters in Ottawa, six regional offices in Canada and 23 offices in eight countries, of which 14 are in the United States. The objective of the Program is to sustain the orderly growth of tourism in Canada through the Marketing and Policy Planning and Industry Relations activities.

16.4 The Grains and Oilseeds Program aims at sustained market growth and an orderly market for grains and oilseeds. The Minister of Industry, Trade and Commerce and the Minister responsible for the Grains Group, share the responsibility for this program.

16.5 The major programs, the man-years authorized and the estimated expenditures included in the 1977-78 Estimates are as follows:

Estimates
(in thousands of dollars)

Program	Man-Years Authorized	Total	Operations	Contributions	Other
Trade-Industrial	2,323	\$278,549	\$ 95,383	\$ 163,937	\$ 19,229
Tourism	322	24,556	23,760	761	35
Grains and Oilseeds	49	87,984	1,932	86,052	-
	<u>2,694</u>	<u>\$391,089</u>	<u>\$ 121,075</u>	<u>\$ 250,750</u>	<u>\$ 19,264</u>

16.6 The Department also has approximately \$2,000 million in assets consisting primarily of investments in Crown corporations, wholly-owned corporations and industrial assistance loans to Canadian firms.

Summary of Audit Office Activities

16.7 Our ongoing examination of the Department has been structured to review the financial management and control system from a number of perspectives. Certain segments including grants and contribution programs, have been selected for periodic rotational audit and our current examination concentrated on a selected number of these. This year's examination included:

- department-wide reviews of certain of the essential elements of the system of financial management and control, such as the organization of the financial function, budget preparation and budgetary control;
- an examination of the Machinery Branch, as part of our Study of Procedures in Cost Effectiveness, in which the emphasis was on the systems and procedures used by the Branch to achieve economy, efficiency and effectiveness in its operations;
- an evaluation of internal audit activities;
- an examination and evaluation of the practices, controls and procedures for electronic data processing of financial information;
- an examination of selected grants and contribution programs;
- department-wide reviews of the controls over various types of expenditures supplemented by a review of the control over these expenditures in selected responsibility centres (branches); and
- follow up of recommendations made by this Office in previous years.

16.8 In planning and carrying out these examinations, we integrated with our normal annual audit the procedures and approaches developed in a number of special audits and studies we completed over the last few years.

16.9 Our 1977-78 audit resulted in 13 interim reports to the Department containing approximately 140 individual recommendations. The following sections of this Chapter summarize the more significant issues reported to the Department during the year.

Recent Initiatives by the Department

16.10 Over the last year, the Department has made improvements in its financial controls and the organization of its financial function, which are discussed in more detail in the following paragraphs. Appointment of a Director General, Finance and Administration, the issuance of a comprehensive mandate for internal audit and the commission of an independent study of the financial function testify both to recent improvement and to an intention to improve further in the future. In addition, a number of the observations and recommendations included in the detailed interim reports issued to the Department during 1977-78 have now either been addressed or are under serious consideration.

16.11 Although the demonstrated intent to improve does not lessen the significance of problems identified in this Chapter, it does provide reason for optimism when considering their resolution.

Organization and Role of the Financial Function

Introduction

16.12 The responsibility for operating the Department rests with the Minister, the Deputy Minister and the Management Committee. The Management Committee consists of the Deputy Minister, seven Assistant Deputy Ministers and the Director General, Finance and Administration.

16.13 The Financial Services Branch, which has principal responsibility for the financial systems, employs 70 people, reporting through the Branch Director to the Director General, Finance and Administration. It maintains accounting records for the Department and its officers have payment authority under Section 26 of the Financial Administration Act. Financial control and accounting, with a few minor exceptions, is centralized in Ottawa.

16.14 The degree of financial authority in other branches varies. In general, the Branch Directors have signing authority under Section 25 of the Financial Administration Act to commit funds. Project officers, under the supervision of the Branch Directors, initiate departmental processing of requests and claims for assistance programs, and give approval under Section 27 of the Financial Administration Act to indicate that work has been performed. Financial personnel are supported by the Professional and Administrative Services Branch which assigns administrative officers to each branch to assist in accumulating and transmitting financial data to the Financial Services Branch.

16.15 The Department has engaged the Bureau of Management Consulting to conduct a study of its financial function -- a clear indication of its intention to improve the system of financial management and control.

General Assessment

16.16 Although the financial administration and control system functions adequately, there is a need for stronger central financial planning and direction. There is also a need to ensure that the non-financial responsibilities of the Department's senior financial officer are kept at a level where he is able to devote the time and effort required to provide the financial direction, advice and leadership that are essential.

Role of Senior Financial Officer

16.17 Responsibilities. The Director General, Finance and Administration, who is the designated senior financial officer, is responsible to the Deputy Head for the following five branches of the Department: Financial Services; Professional and Administrative Services; Legal Services; Office of Departmental Review (Internal Audit); and Office of Information and Public Relations. We recognize that the recent relocation and reorganization of the Department has required the Director General to devote an unusual amount of time to non-financial matters. However, we are concerned that the continuing demands of his non-financial responsibilities may detract from his ability to act as the senior financial adviser to the Deputy Minister and his senior staff and to carry out the other responsibilities normally associated with the role of the senior financial officer.

16.18 A review should be made of the responsibilities assigned to the Director General, Finance and Administration, to ensure that non-financial duties do not unduly hamper his ability to carry out his responsibilities as the Department's senior financial officer.

16.19 Financial responsibility at branch level. The responsibilities of personnel who do not have full-time financial positions, for financial administration and control at the branch or program level, have not been clearly formulated and documented. In particular, formal instruction and guidance is required on maintaining branch accounting and commitment records and on the use and follow-up of centrally produced financial reports, as well as an awareness of prescribed departmental financial practices and procedures.

16.20 *The senior financial officer should develop and issue instructions on aspects of financial administration and control carried out by employees who do not have full-time financial responsibilities.*

16.21 Operational Performance Measurement System. The Treasury Board has directed that by 1980 all departments are to develop and incorporate into their management reports, to the greatest possible extent, performance measurement data for programs, activities, jobs, etc.. To this end, the Department has begun a program to identify measurable program outputs and to provide appropriate units of measure in each work program. Responsibility for implementing the program, previously co-ordinated by the Internal Audit Branch, has not been reassigned.

16.22 *The senior financial officer should assign specific individuals to continue to develop and implement the Operational Performance Measurement System.*

Machinery Branch - Management Controls

Introduction

16.23 This section reports on one of a series of studies carried out under the Auditor General's Study of Procedures in Cost Effectiveness (SPICE), a project designed to explore and develop the concept of value-for-money auditing. It focused on how managers control operations at the Branch level and evaluate their effectiveness. It reports on findings as of July 1977.

16.24 The major concern of the Department is the Trade-Industrial Program. Policy branches develop its department-wide policies, while other functional branches provide important common support activities and design and monitor major department-wide delivery programs. These department-wide programs can be characterized as either Financial Assistance, Duty Remission or Export Promotion programs.

16.25 Seven branches, each responsible for furthering the objectives of the Program within a particular sector of Canadian industry, carry out the actual delivery of assistance to firms. Each branch formulates and implements sector-related strategies, processes applications under department-wide programs and provides advice and information services to sector firms and related agencies.

16.26 The Machinery Branch, which is one of the seven branches referred to above, employs 83 people and has an annual operating budget of about \$2 million. During the year ended March 31, 1977, it administered grants and contributions of about \$10 million and recommended duty remissions of about \$200 million.

Scope of the Audit

16.27 The purpose of this audit was to review within a representative industrial sector branch:

- the evaluation procedures used to measure and report program effectiveness; and
- the adequacy of management controls over operations.

16.28 The Department suggested and the Office selected the Machinery Branch after examining other alternatives. We examined the following with respect to procedures and roles concerning program effectiveness:

- five sub-sectoral divisions, each responsible for a sub-sector of the industry sector assigned to the Machinery Branch;
- the Policy Analysis Group of the Branch; and
- Branch management.

We also examined the operational procedures followed by:

- the Program Division which processes machinery sector applications under five department-wide financial assistance programs (Programs since incorporated into the Enterprise Development Program); and
- the Machinery and Equipment Advisory Board Secretariat which administers the Branch's main duty remission activities.

General Assessment

16.29 There is a need for the Machinery Branch to improve its procedures for measuring and reporting the effectiveness of assistance provided to the machinery sector of Canadian industry. Sectoral objectives and corresponding Branch strategies have not been adequately defined nor their implementation sufficiently monitored.

16.30 The Department has evaluated quantitatively the sectoral effects of only some of its many department-wide programs for financial assistance and duty remission. As a result, the Branch lacks objective data needed to assess relative contributions of these programs and to develop strategy accordingly. Further, the Branch has not clearly identified the planned effects and adequately monitored the actual effects of its sectoral advice and service activities.

16.31 The Branch also needs to investigate the consequences of incomplete and inaccurate information in its data bank on Canadian machinery manufacturing capabilities, to determine appropriate standards of completeness and accuracy and to take necessary steps to meet them. Furthermore, it does not adequately measure and report the number and causes of inquiries, complaints and application re-submissions with respect to duty remissions under the Machinery Program.

Effectiveness

16.32 Our audit disclosed that Sector objectives and corresponding Branch strategies are not clearly stated. The Branch has not specified these objectives in operational terms such as:

- the nature and degree of the change which should be occurring in specified characteristics of the Sector;
- the kinds and numbers of firms that should be encouraged to use assistance;
- the characteristics of assisted firms that should be changed and the extent of planned changes; and
- the forms and amounts of assistance that should be provided to the various kinds and numbers of firms.

16.33 Most department-wide programs for delivery of assistance to the Machinery Sector through the Machinery Branch have not been evaluated for their effectiveness. As a result, the Branch is provided with limited data to help plan and evaluate Sector objectives and strategies. The Department needs to give increased emphasis to its efforts to evaluate the effectiveness of these major programs.

16.34 The Branch also should monitor the immediate effects of its sectoral advice and service activities. Operational effectiveness indicators would provide improved insight into the extent to which it is accomplishing its objectives. It could maintain records to:

- monitor actual results against quantified objectives;
- determine the proportion of trade post inquiries passed on to firms that have been acted on and associated with export sales;
- determine to what extent advice to firms concerning rationalization, specialization, technological changes, unique developments, etc., are associated with corresponding action and beneficial results; and
- analyse the extent to which sundry development project advice to firms, buyers, U.S. parent companies and provincial and federal government departments achieves anticipated results.

16.35 *The Department should aim at making quantitative evaluations of all of its department-wide programs. The Machinery Branch should strive to extend the application and use of activity and effect monitoring for sectoral strategies and the advisory and service assistance it provides to the Machinery Sector.*

The Machinery and Equipment Advisory Board Secretariat

16.36 The data bank on Canadian machinery manufacturing capabilities that the Machinery Branch uses to assist in appraising import duty remission applications is neither complete nor accurate in all respects. No information is available on the impact that missing and inaccurate data may have on the total costs and benefits of maintaining and using the data bank. Accuracy and currency of data bank information contributes to the effective operation of the machinery program. Wrong information may lead to:

- unjustified remission of import duties on items available in Canada;
- failure to provide tariff protection to eligible Canadian manufacturers;
- unjustified import duty when an item is no longer available from Canadian sources; and
- increased re-submissions and complaints from dissatisfied applicants.

16.37 We understand from our discussion that "hard" statistical data does not exist on how many of these potential situations have occurred. It is not possible to assess the consequences until the frequency of such hypothetical occurrences has been identified

16.38 *The Machinery Branch should investigate the consequences of incomplete and inaccurate information in its data bank on Canadian machinery manufacturing capabilities determine appropriate standards of completeness and accuracy and take necessary steps to meet these standards.*

16.39 The Machinery Branch does not adequately measure and report the number and causes of enquiries, complaints and application re-submissions.

16.40 *The following procedures should be introduced on a temporary basis to determine their economic advantage:*

- *the number of application re-submissions should be reported and the causes analysed; and*
- *the number of complaints and inquiries from applicants about their applications should be reported and categorized as to their causes.*

Internal Audit

Introduction

16.41 For the last three years, internal audit in the Department consisted of a financial audit carried out under contract by the Audit Services Bureau of the Department of Supply and Services. The contracted services from the Bureau were terminated on March 31, 1978. On October 12, 1976, a directive from the then Deputy Head of the Department established the Office of Departmental Review. For a variety of reasons its present mandate as the Department's internal audit group was not approved until the Department Management Committee met on October 3, 1977. The composite audit program approved at that meeting aimed at covering all aspects of internal audit including financial, operational and personnel.

16.42 From late 1976 to November 1977, the Office of Departmental Review devoted most of its time to such management functions as participation in the operation of the Department's resource allocation process, the mid-term review of work programs, and certain special studies for the Deputy Head.

16.43 The staff complement at March 31, 1978, comprised a Director, six operational auditors, three financial auditors and two support staff. The Director reports both to the Department's Audit Committee and to the Director General, Finance and Administration.

Scope

16.44 In paragraph 2.19 of my 1977 annual Report, I announced that my Office had initiated a review to determine whether the whole area of auditing within the Federal Government represents good value for money. Our review sought to ascertain whether the Deputy Minister gets the kind of information and advice from internal audit that he needs to assist in managing the Department and whether my Office can place sufficient reliance on the audit work of the internal auditors to affect materially the nature, timing and extent of our audit work. To meet these objectives, we examined material concerning internal audit's organizational status, use of resources, planning of activities, audit practices and reporting and audit follow-up.

General Assessment

16.45 Our review leads us to conclude that senior management of the Department did not provide the support and direction essential to a successful internal audit program. The formation of the Office of Departmental Review and the departmental Audit Committee are both progressive steps in developing an effective internal audit activity. Although this speaks well for the future, it is vital that senior management and the departmental Audit Committee actively support the new mandate of internal audit and provide the necessary direction and leadership. Also, the head of internal audit should report directly to the Deputy Head to ensure the independence and objectivity of the audit function. Finally, the original master audit plan should be revised to reflect functional, department-wide and branch audits of all departmental programs and activities.

Reporting Level

16.46 The Office of Departmental Review is one of five branches which report to the Director General, Finance and Administration, who approves the Office's annual operating budget for both man-years and non-salary costs. Two other branches, which report to the Director General, Finance and Administration, Financial Services and Professional and Administrative Services, are material elements of internal audit's potential audit universe within the Department. Their common reporting relationships with the Office of Departmental Review may prejudice the independence of the audit function.

16.47 *The head of internal audit should report directly to the Deputy Head.*

Incompatible Responsibilities

16.48 Since its creation in late 1976, the Office of Departmental Review has been responsible for certain functions not compatible with its primary role. These lessened its ability to provide an impartial assessment of the Department's operations. In 1977, these additional responsibilities, relating mainly to the resource allocation process, work program challenge and review, and the mid-term review, were transferred to more appropriate branches. Although internal audit can still play a key role in carrying out

special audit investigations of sensitive areas or matters of immediate concern to the Deputy Head or the Audit Committee, care must be taken not to prejudice its effectiveness by creating a situation which might lead to a conflict of interest.

Audit Committee

16.49 On November 3, 1977, the departmental Management Committee approved the formation of a departmental Audit Committee consisting of the Deputy Head as its Chairman, the Director General, Finance and Administration and one of the ADM - Operations. Since the date of its formation to June 30, 1978, the Audit Committee had not formally met.

16.50 The Department has taken a step in the right direction in establishing an Audit Committee comprised of senior officers. It should be a matter of concern, however, that the Committee had not formally met some eight months after its formation and after the Office of Departmental Review began its 1978-79 work plan. Effective internal audit requires significant planning, the input of senior management, and the review, challenge, approval and support of plans by the Audit Committee. For reasons outlined later in this section, we believe the original three-year audit plan did not address a number of significant aspects of the Department's activities, nor did it address certain areas that concern senior management.

16.51 *The Audit Committee should meet as soon as possible to establish written terms of reference for itself and to review, challenge and approve the 1978-79 internal audit plan.*

Coverage

16.52 1978-79 Plan. The 1978-79 internal audit plan is embodied in the work program for the Office of Departmental Review. A listing of responsibility centres scheduled for audit over the next three years and the estimated number of man-weeks for each assignment supports the plan's composite audit segment.

16.53 From discussion with officials in the Office of Departmental Review, an examination of the detailed three-year plan and our experience in auditing the Department, we concluded that the plan falls short of clearly identifying all potential areas for audit in the Department. It is completely structured around a review of activities at the branch level and does not recognize the possibility of conducting audits from differing perspectives. Consequently, there is an urgent need for the internal audit group to analyse and define carefully the audit universe subject to its mandate. We believe the original plan should have given recognition to the following possible audits:

- department-wide functional audits such as payroll, travel, contracting, etc.;
- department-wide reviews of certain essential elements of the system of financial management and control such as budget preparation and control, financial reporting, etc.;
- separate and distinct audits of grants and contribution programs, since many of these programs impact on several responsibility centres;
- those vital aspects of the Department's operations and elements of the system of financial management and control that should be reviewed on an annual basis as opposed to every three years; and

- the grains and oilseeds grants and contribution programs, which were specifically excluded from the plan.

16.54 *A model of the Department and related agencies should be prepared, showing all programs and activities that can be considered as potential audit candidates, as a basis for developing an internal audit plan. The model should be updated at least annually.*

16.55 Assessment of potential audit areas. The timing and extent of audit in the original plan was based primarily on the impact of the Department's reorganization in 1977. Branches subject to significant change under reorganization were scheduled for audit in the latter part of the three years, while those little affected by reorganization or identified in the mid-term review process as areas of concern were selected for audit in the first year.

16.56 The basis for selecting and timing audits in the present plan ignores many conventional selection criteria as well as certain areas of significant concern to senior departmental management. The examination our Office completed in the current year also identified several significant areas of concern which should have been considered in assessing potential audit areas.

16.57 *The Office of Departmental Review should develop a policy which clearly establishes the criteria to be used in selecting possible audit areas and the timing and the extent of work to be completed.*

Development of Annual Work Plan

16.58 Individual assignments in the Branch's present work program are not supported by written memoranda outlining the scope of coverage, extent of tests and estimated audit time by each distinct phase of each assignment.

16.59 *The audit plan should be supported by an individual memorandum on each assignment detailing the areas and issues to be addressed, and the estimated audit time by audit function.*

Audit Practice

16.60 Since the Office of Departmental Review is still in the development stage, it is not surprising that little exists in the way of formal methodology, procedures, programs or other matters related to professional practice. As the Branch develops and refines its audit approach over the next few months, these basic ingredients should begin to crystalize and could form the basis for the development of a comprehensive audit manual.

16.61 *The Audit Branch should formalize its procedures, programs and practices and develop a comprehensive internal audit manual.*

Budgetary Control

Description of Present Budget Preparation System

16.62 The requirements of Treasury Board and Parliament govern to a large extent the elements and timing of the budgetary cycle. However, within those constraints, which consist primarily of submitting Program Forecasts each March and Estimates each October, departments design their own internal

system to generate the information they require for Treasury Board submissions and for internal resource allocation, budgetary control and performance measurement.

16.63 The Department relies heavily on its work program system as the basic framework for budgetary control. Responsibility centre managers, with some direction from senior management as to form and general guidelines, prepare work programs annually, covering each of the following two years. Plans for each responsibility centre are established within the total resource ceilings imposed by senior management, by classifying all activities into "jobs" for which priorities are then established. A "job" is defined as "a commitment of a responsibility centre to carry out a task within a specified time frame, for a stated cost and an identified result". The work programs are submitted to Assistant Deputy Ministers who forward them to the Director General, Finance and Administration, after approval.

16.64 Work programs show man-years and non-salary costs by job, but do not break costs down into standard objects of expenditure. After the centralized approval of work programs, managers classify total approved branch expenditures by standard objects for the coming year. This information is then submitted to the Financial Services Branch to be recorded in the financial management reporting system as that responsibility centre's operating budget for the coming year.

Scope

16.65 The procedures governing the preparation of budgets and the entire system of budgetary control are key elements in a department's system of financial management and control. We have therefore reviewed the systems and procedures involved in budget preparation and budgetary control for the fiscal year ended March 31, 1978.

General Assessment

16.66 Over the last few years, the Department instituted a system of work programs which entails preparing budget plans on a program-oriented basis rather than by objects of expenditure. The system is basically sound and is capable of providing an appropriate framework, both for planning and budgetary control. However, for a number of reasons the work program system is not yet meeting all of its objectives.

16.67 The two major factors contributing to the system's failure to meet its objectives are a lack of:

- adequately documented procedures to be followed in the development, challenge, review and follow-up of work programs; and
- acceptance and belief in the system by many of those responsible for the preparation and review of work programs.

Planning

16.68 Communication of priorities and guidelines. As part of the planning that precedes each year's budget preparation, the Deputy Minister informs his Assistant Deputy Ministers of the guidelines on departmental priorities based on his discussions with the Minister and instructions from the Treasury Board and Privy Council Office. The Assistant Deputy Ministers translate these broad guidelines into more specific guidelines to managers who report to them. However, these guidelines and priorities are often communicated orally instead of in writing. Oral communication can often be misinterpreted and this risk is compounded each time the same information is passed from person to person.

16.69 *Executive guidelines or priorities should be communicated in writing, supplemented by discussions at each stage of the budgetary process, to ensure consistent interpretation.*

16.70 Long-term plans. Objectives and sub-objectives the Department outlined in the Estimates are essentially medium to long-term in nature. Departmental plans and forecasts, however, normally relate to the short-term only. We believe the Department needs to develop a long-term plan which would be reviewed and updated on a regular basis and communicated to appropriate levels of management within the Department, to allow them to organize their own spheres of responsibility in line with the departmental long-term plan.

16.71 *The Department should develop a long-term (e.g., five-year) plan which would identify intermediate goals and points of decision and would allow monitoring of progress towards longer range objectives.*

Preparation of Work Programs

16.72 Guidance on the preparation of work programs. Despite the commitment of the Deputy Minister, many managers do not believe in the merit of the work program system in the current environment, and attempt to remain as general as possible when identifying tasks and objectives. This attitude receives a form of official sanction when programs prepared in such a fashion are accepted, even though the results may not provide a reliable basis for resource allocation or budgetary control. The system of budgetary control will function effectively only if it has the support of those responsible for work program preparation. A practical means of resolving these problems must address both the existing communication gap between senior management and managers and the need for continuous education and training in the entire process.

16.73 *Senior management should reinforce the Department's commitment to the work program system as an essential ingredient in the system of budgetary control by insisting that work programs be prepared in a manner that will ensure compliance with the system's purpose.*

16.74 Challenge and review of work programs. To date, there has not generally been any formal or effective detailed review and challenge of work programs by senior managers before approval by an Assistant Deputy Minister.

16.75 *Challenge committees should be established under each Assistant Deputy Minister to review work programs in detail, and financial officers assigned to programs should be members of these committees.*

Control over Operations and Activities

16.76 Time-phasing of Operating budgets. Operating budgets are normally prepared on an annual basis only, and no consideration is given to the expected timing of the expenditure or output. An implicit assumption is that all expenses and outputs accrue evenly over the year. In fact, many types of expenditures and outputs do not accrue evenly throughout the year, but have predictable months of concentration. If budgets are not time-phased, comparisons during the year of planned and actual expenditures and outputs may be misleading.

16.77 *Operating budgets should be prepared by month or quarter, so planned and actual results can be compared and changes in anticipated spending patterns can be detected immediately.*

16.78 Accountability for results. Jobs and anticipated results proposed in work programs are approved in advance by managers who also approve changes in these programs. Although there is a formal mid-term review managers are not required to report formally once a year on the results or to explain differences between the actual and anticipated results.

16.79 Responsibility Centre Managers should be required to report at least annually on the results produced by each of the jobs included in their work programs and to explain differences between actual and anticipated results. Summarized versions of these reports would provide a useful means for Assistant Deputy Ministers to report to the Deputy Minister.

16.80 Independent program review. The work program system has now been in operation for several years. Managers are required to go to great lengths to analyse the expected activities of their branches into jobs, to identify the anticipated results of the jobs, to assess the costs of producing the results of those jobs, and finally to assign priorities to the jobs in the context of the instructions received from the Assistant Deputy Minister responsible for the branch. However, to date there has been no subsequent independent check by any group within the Department to ensure that branches are expending resources on the jobs outlined in the work programs or that departures from plans are authorized.

16.81 A program review process should be instituted by internal audit to ensure that branches are expending resources for the purposes indicated when budgets were approved.

Financial Reporting

Introduction

16.82 Departmental financial transactions may be recorded in as many as three separate financial systems. In addition to the reports provided by the Department of Supply and Services, the Department maintains its own Financial Management Reporting System and many branches within the Department maintain supplementary manual accounting records. The Financial Services Branch retains the Department of Supply and Services reports which are not distributed elsewhere in the Department. Except for standard salary and detailed commitment data, identical expenditure data are put into the Department of Supply and Services system and into the internal system. The two systems are reconciled on a regular basis. Branch records may include simple travel expenditure logs or, in some cases, detailed information on expenditures and commitments which often duplicates data in Financial Services Branch records.

Scope

16.83 We examined the systems of financial reporting as an integral part of our audit of the Department for the 1977-78 fiscal year. Our review was designed to assess the adequacy of these systems as important elements of the management control system with particular attention being given to the internal Financial Management Reporting System. We also reviewed the extent of duplication between this system, the central Department of Supply and Services reporting system and branch accounting systems. We reviewed these systems by analysing the reports produced by the Financial Management Reporting System and by interviews with departmental personnel. We did not examine external reporting in the Public Accounts of Canada.

General Assessment

16.84 The Department has developed a reasonably timely internal financial reporting system that reports expenditures and some commitments on a monthly basis. Its effectiveness could be improved if financial information were accounted for and reported on the same basis as work programs are prepared. An effective variance analysis system is required. The existence of a number of unofficial branch accounting systems, the changes required in the central accounting system, and our interviews with various users of financial reports lead us to conclude that there should be a comprehensive review of the financial reporting requirements of responsibility centre managers.

Basis of Reporting

16.85 Current monthly financial reports show objects of expenditures for each responsibility centre. However, operating budgets prepared as part of the work program system are prepared for "jobs", of which there may be several in a given responsibility centre. Since actual expenses are not reported by job, it is difficult to make a meaningful comparison between budgeted and actual data. This inadequacy reduces the accountability of managers since actual results cannot be compared to the budget in which plans were stated and on which approval was given. Part of the solution may be to redefine jobs in the budget preparation phase, so levels of activity are identified and budgets prepared for which actual costs can be identified and reported.

16.86 *To ensure that work programs represent an effective control mechanism, actual costs should be captured and reported on the same basis as work programs are prepared.*

Reporting Performance Measures

16.87 Performance measurement systems are being developed for a number of the Department's activities. However, program outputs have not been incorporated in monthly financial reports. By comparing actual outputs to planned outputs, when comparing actual to budgeted expenditures, the Department could determine what has been accomplished for the dollars spent, and to what extent results differ from plans. This, in turn, could indicate the magnitude of any problem that may exist and what corrective action is required.

16.88 *Actual program outputs should be reported in relation to planned outputs to assess whether objectives are being met and to facilitate corrective action.*

Use of Financial Reports

16.89 Reporting to the Management Committee. Periodically, generally quarterly, the Director General, Finance and Administration, submits a report called the "Departmental Forecast" to the Management Committee. Prepared within the Financial Services Branch, this report contains explanations of projected year-end variances based on spending patterns and discussions with managers if there is some uncertainty as to the cause of a variance. Although individual managers are responsible for their budgets, they do not have the primary responsibility for explaining variances. Comparison of budgeted and actual expenditures and outputs, and comprehensive variance analysis explaining the causes of departure from plan, are essential elements of financial management and control. Only through such procedures can problems be identified on a timely basis and appropriate corrective action taken where necessary.

16.90 *A variance analysis system should be developed requiring managers to explain significant variances in actual costs and outputs from the budget.*

16.91 Communication. Users of reports should understand the types of information they contain and any limitations (such as cutoff dates) that reports might have. Our interviews with line managers disclosed that in many cases they do not understand centrally produced reports and in some cases do not use them.

16.92 *Training in the use and interpretation of financial reports should be a vital element in the orientation of new managers and in refresher courses for existing managers.*

Commitment Reporting

16.93 A recent departmental study on the financial reporting system stated that the commitment data now reflected in monthly reports represent only 40% of the possible outstanding commitments at any month-end. As a result of the unreliability of centrally produced commitment data, branches also maintain commitment records, and these manual records are the ones branch officials generally rely on when certifying under Section 25 of the Financial Administration Act. Furthermore, Financial Services Branch officials frequently telephone the branch for information from these records before certifying under Section 26 of the Financial Administration Act.

16.94 Changes being developed in the computerized system include major revisions in the method of recording and reporting commitment data. An effective budgetary control system would reduce the necessity for a comprehensive commitment reporting system. In the interim, it may be feasible for Financial Services Branch to discontinue its input of commitment data, since its records are currently not relied on.

16.95 *Action to improve the centralized commitment accounting system should be continued. Once it is operational, the maintenance of commitment records within branches should be strongly discouraged by senior management.*

Electronic Data Processing

Introduction and Scope

16.96 The Department's in-house computer hardware consists of a medium-size mini-computer, an intelligent data-entry system and numerous terminals of both the remote batch and interactive types. The Department does not have a large scale computer for data processing, and computer-based data are processed largely at service bureaus.

16.97 This segment of our audit included the examination of the Management Systems Division, its current practices and future plans, and the controls and procedures for processing financial information within the Financial Services Branch. In addition, we reviewed and evaluated the two main financial applications, the Financial Management Reporting System and the Grants, Loans and Contributions System.

General Assessment

16.98 Our examination disclosed a number of areas where improvement could be made. Senior Electronic Data Processing management is aware of many of these inadequacies and plans corrective action.

Long-Term Planning

16.99 Effective control over Electronic Data Processing operations requires close direction by senior management. This direction can most appropriately be provided by an Electronic Data Processing steering committee comprised of executive officers of the Department. At present the Department has no such committee or any other form of executive direction over Electronic Data Processing.

16.100 *The Department should create an executive Electronic Data Processing steering committee to approve annual and long-range plans and to determine and establish priorities for the Department's Computer Processing activities.*

Security Clearance

16.101 A Treasury Board directive requires security clearance for any Electronic Data Processing facility involved in processing classified data. We have been informed that a security clearance report has not been completed for the service bureaus the Department uses.

16.102 *Senior officials of the Department should inform Department of Supply and Services that security clearance has not been obtained for the service bureaus processing its data and that one should be completed as soon as possible to ensure the confidentiality of information.*

Back-Up Facilities

16.103 No formal procedures cover off-premise storage of computer program libraries, disc or tape master files, critical data and transaction files, or for systems documentation. The service bureaus do back up some programs automatically and retain some of the tape files, while other tape files are currently stored at the Department.

16.104 *Procedures for off-premises storage should be formalized, implemented and enforced. These procedures should encompass all critical machine-readable files, instructions, standards manuals and other critical documentation.*

16.105 During our review, we noted that there is no computer equipment back up plan to cover the possibility that existing facilities are unable to function.

16.106 *The Department should develop a computer equipment back up plan to encompass all processing facilities, equipment, files and documentation.*

Documentation of Systems and Programs

16.107 The Management Systems Division reference manual is incomplete and out of date. It does not contain procedures for production control, computer room access, job scheduling or data conversion. The standards and instruction manuals, flowcharts and documentation binders we reviewed were also incomplete and out of date. Proper documentation of systems, clerical routines, programs and procedures is essential to facilitate changes in the system, user and system group understanding and new employee training.

16.108 *Projects to update existing systems documentation and procedures manuals should be completed and compliance should be enforced.*

Physical Control over Programs and Documentation

16.109 Documentation for the Management Services Division systems and programs is scattered throughout the Division, controlled by the individual who developed or assumed responsibility for it. The operations group controls some of the computer program libraries while various project leaders and their staffs control others.

16.110 *All programs, systems and program documentation should be under the control of a librarian.*

Segregation of Duties

16.111 There is inadequate segregation of duties for the functions of Data Base Administration, Development Programming, Maintenance Programming, Quality Assurance, Program Librarian, Operations and Data Control, particularly in the Financial Systems group of the Management Services Division. The plan of organization in the Division should place a high degree of importance on the segregation of duties due to the concentration of the processing function in one area. The arrangement of duties must provide the framework within which the methods and procedures will operate to ensure the safeguarding of assets and the reliability of records.

16.112 *To provide more effective internal control, responsibility for certain closely related functions in the Management Systems Division should be adequately segregated, particularly in the area of Financial Systems.*

User Participation

16.113 The Department's Administrative Manual contains procedures requiring the involvement of user groups in Electronic Data Processing activities. Our review indicated that user participation in Electronic Data Processing activities is inadequate and that user groups are not formally approving:

- changes in programs and systems;
- the acceptance of a system; and
- the continuation of a project at each major phase of its development process.

In addition users are not participating in testing new or changed systems or in performing a system test of the non-Electronic Data Processing portion of a developed or changed system.

16.114 *Procedures in the Department's Administrative Manual relating to user group involvement in Electronic Data Processing activities should be complied with and enforced.*

Grants and Contributions

Introduction and Scope

16.115 Grants and contribution payments represent over 60% of the estimated total expenditures of the Department for 1977-78. In this segment of our examination we selected the following four major programs, which account for approximately 54% of the estimated grants and contributions:

- Enterprise Development Program;

- Two-Price Wheat Act, 1974-5-6, c. 54;
- Grain Hopper Cars; and
- Shipbuilding Industry Assistance Program.

Enterprise Development Program

16.116 The Enterprise Development Program, a major financial activity of the Department, came into existence in April 1977 and consolidated seven of the existing assistance programs. The basic objective is to improve the viability and international competitiveness of eligible Canadian manufacturing and processing firms. It provides assistance, within the indicated ceilings, to Canadian companies in the form of:

- contributions towards the costs of eligible projects where the project represents a significant burden on the resources of the firm (\$26 million for 1977-78);
- guarantees of repayment ("loan insurance") of up to 90% of loans made by lending institutions to approved firms which cannot obtain debt financing on reasonable terms and conditions on their own (not to exceed \$250 million); and
- direct loans to firms in the Footwear and Tanning Industry (\$6 million for 1977-78).

16.117 The Enterprise Development Branch of the Department administers the program on behalf of the Enterprise Development Board, whose members are appointed from the private and public sectors. Regional Boards have also been established in each province, with authority to provide assistance of up to \$200,000 per company.

16.118 General assessment. Our examination disclosed a number of serious problems and weaknesses in the Program's system of financial management and control. Although certain problems may be attributable to the newness of the Program, many weaknesses were inherited from the predecessor programs. In particular, immediate action is required to resolve the issues and problems associated with the significant refundable contributions outstanding under the Program for Advancement of Industrial Technology (PAIT) I.

16.119 Financial analysis of applications to regional boards. Financial viability of a company is a key prerequisite for assistance, particularly a request for loan insurance. At the central level, the Program Analysis Group assesses the financial viability of an applicant. At regional offices, regional project officers, who are not necessarily required to have training and competence in financial analysis, assess the applications.

16.120 The Department has recognized the problems that can result from financial analysis of regional submissions by untrained analysts and has obtained Treasury Board approval for an additional 20 man-years for the 1978-79 fiscal year. We were informed that about half of these man-years will be utilized for financial analysts in the regional offices. Until these positions are filled and the additional staff trained, lower standards of financial analysis increase the risk of loss.

16.121 *Until suitable trained financial analysts are on site at each regional office, the Program Analysis Group should monitor the financial analyses at each regional office.*

16.122 Control over PAIT I repayable contributions. PAIT, one of the seven programs consolidated into the Enterprise Development Program, was approved by Cabinet in 1965. Under the initial program (PAIT I) which terminated in 1970, the Department funded a portion of a company's costs on approved research projects, with the provision that the contribution would be repaid with interest should the results be exploited commercially. After completion, the Department and the company assessed the technical success and commercial viability of the project. If deemed successful and exploitable, the Department negotiated a repayment agreement with the company covering terms and interest rates. On unsuccessful projects, it signed a termination agreement releasing the company from repayment liability.

16.123 Under the PAIT I program, 200 projects were funded for \$23.4 million. The Department's analysis of these projects indicated that 68 have terminated (\$4.4 million), 21 have been fully repaid (\$1.0 million), 10 recipients are bankrupt (\$1.3 million), 43 have signed repayment agreements but have not fully repaid (\$10.2 million) and the repayment status of 58 projects is not resolved (\$6.5 million). Approximately \$5 million of unpaid interest is outstanding on projects with repayment agreements.

16.124 Administration and control of the PAIT I program have not been effective in ensuring the maximum repayment of contributions to the Department on a timely basis. This is evidenced by the lack of:

- negotiated repayment or termination agreements with 58 recipients even though the program terminated eight years ago;
- independent verification of sales data reported by companies with repayment agreements; and
- systematic monitoring of the sales of companies which have yet to negotiate repayment agreements.

16.125 Although the Department has not acted recently to resolve individual case problems, it has started to examine possible alternatives for dealing with outstanding amounts under the terminated program. One alternative under consideration is to recommend that the Government cancel all or part of the repayment obligations of these companies. Twice in recent years, the Treasury Board rejected plans involving forgiveness of potentially refundable amounts under this program. The Department, however, has chosen to address these broader policy questions before undertaking further negotiations with assisted companies. Although this is understandable, the Department's problems with the program's administration and the impact on the financial structure of companies facing repayment are such that positive and prompt action is required at senior levels. Resolution of these problems should be given immediate priority.

16.126 Senior officials of the Department should ensure that potential recoveries under the PAIT I program are analysed, policy issues are resolved, and negotiations with all assisted companies are concluded as quickly as possible.

16.127 Holdback liability. Companies receiving assistance under the Enterprise Development Program submit progress claims as they spend funds on their respective projects. Progress claims up to 90% of the agreed assistance are paid routinely, but the final 10% is not paid until:

- the project is completed or terminated;

- a final claim certified by the company's external auditors is received; and
- the Department has reviewed the procedures of the external auditors or performed any additional verification considered necessary.

16.128 Progress claims exceeding 90% are not paid but are recorded in a holdback liability account until the three conditions noted above are satisfied. The financial system does not produce regular reports on the holdback account. A report in January 1978 listed all projects and amounts credited to the holdback account but gave no indication as to how long they had been in that status. In January 1978, the holdback account amounted to approximately \$3.5 million, representing at least \$35 million of disbursements. Many holdbacks date back several years; in fact, our test sample showed that one, amounting to \$58,180, has been in the account since October 1973 and another amounting to \$100,000 since October 1974.

16.129 A regular report, prepared on an aged basis, would provide a useful starting point to control the number and amount of projects credited to the holdback account. Such a report would provide a basis for instituting follow-up action with companies to determine the status of the project, particularly one that has been in holdback for a long time.

16.130 All projects in the holdback liability account should be reviewed and followed up and appropriate reports prepared for senior management.

16.131 Audits of contributions. Present procedures do not ensure that all PAIT projects will be subject to audit. For example, if a company does not submit a final claim signed by an external auditor, the Department does not carry out an audit. If the Department is encountering difficulty in obtaining the external auditor's certification of costs, it would seem that the project should be a prime candidate for an audit.

16.132 Appropriate criteria should be developed for selecting and timing audits of contributions under this program.

16.133 Disclosure to Parliament of loan insurance activities. We did not assess in detail the adequacy of the financial disclosure in the Estimates and Public Accounts, but our review did provide a prime example of a situation where these documents could have presented more complete information to Parliament.

16.134 Although the loan insurance segment of the Enterprise Development Program constitutes a major financial activity, the Estimates and the Public Accounts disclose little information about it. The Estimates do not show the amount of loan insurance to be approved during the year, anticipated premium revenue, losses expected, contingent liabilities or number of contracts written. The outstanding contingent liability for loan insurance at March 31 each year is shown in the Contingent Liabilities Table in Volume I of the Public Accounts (page 10-101 in 1976-77 showed a contingent liability of \$68,418,301). Losses are charged to the Consolidated Revenue Fund under Section 22 of the Financial Administration Act and premium revenue is credited to "Miscellaneous Revenue". Neither revenues nor losses are identified with the loan insurance program in the Public Accounts. Disclosure of authorized ceilings, premium revenues and losses for the year in the Estimates and Public Accounts would provide more complete information for Parliament to assess the impact of the Program. Under present procedures, no information would be presented in the Estimates unless the Department was requesting a change in the Program.

16.135 *The Department should discuss with the Treasury Board Secretariat and the Office of the Comptroller General improved disclosure of the financial operations of the loan insurance program in the Estimates and the Public Accounts.*

Grains and Oilseeds

16.136 Introduction and scope. Our examination comprised a review of the two major segments of the Grains and Oilseeds program involving payments under the Two-Price Wheat Act and payments for the purchase of hopper cars.

16.137 Payments under the Two-Price Wheat Act represent subsidies to Canadian consumers and to producers. The Act ensures that Canadian consumers pay no more than \$3.25 a bushel for wheat (or \$5.75 for durum) and guarantees a subsidy to Canadian producers of the difference between these prices and the average export prices, with an upper limit of \$1.75 a bushel. The 1977-78 Estimates and Supplementary Estimates allocated \$19.1 million to this program. Approximately 86% of all payments for 1977-78 were made to the Canadian Wheat Board on behalf of Western and Prairie provinces. The Ontario Wheat Producers' Marketing Board accounts for a further 13%, the remainder going to Quebec and Maritime producers.

16.138 The Hopper Car Purchase Program was set up primarily to move wheat more efficiently in Western Canada and also to aid the slumping rail car industry. Since 1973, 6,000 hopper cars have been delivered to the two major Canadian railway companies at a cost of \$137 million. Payments for the cars have been made from contributions by the Department to the Canadian Wheat Board.

16.139 General assessment. Grants and contribution payments under the Two-Price Wheat Act and the Hopper Car Program are funded by the Department but administered by others. The Department relies on systems of financial control used by the other parties involved. This reliance exists even though appropriate steps have not been taken to formalize the delegation of authorities and responsibilities. Documented means need to be established to ensure that essential aspects of financial management and control are neither duplicated nor overlooked.

16.140 Documentation of responsibilities, authorities and procedures. The two programs typify several of the grants and contributions in the Grains and Oilseeds Program in that the Department acts as the funding agency and other government departments or agencies administer them. Department officials are of the opinion that the Canadian Wheat Board should not be viewed as an arms-length party. They believe that since it is more efficient and practical for the Canadian Wheat Board to establish proper systems of financial control, the Department and the Canadian Wheat Board should formally agree to this course of action.

16.141 The existing documentation and the evidence of financial control is very informal. Although the Department's opinion about the role of the Canadian Wheat Board may be appropriate, the responsibilities, authorities and procedures involved in administering the program are not clearly defined or formally documented. Present practices could lead to the duplication or omission of certain essential aspects of financial control.

16.142 *A memorandum of understanding should be prepared defining the responsibilities, duties, delegations of authority and detailed operating procedures of all parties involved in administering grants and contributions under the Grains and Oil seeds Program. Special emphasis should be placed on all aspects of financial management and control.*

16.143 Payments to provincial wheat boards. Although we believe that a degree of reliance could be placed on the Canadian Wheat Board's system of financial control, this is not necessarily true of provincial wheat boards. For example, the documentation provided by the Canadian Wheat Board includes a certificate from their independent auditors that the figures reported on the invoices are in accordance with the Canadian Wheat Board records. The Quebec figures are certified through confirmation of bushels with millers purchasing the wheat. However, there is no similar verification from the Ontario Wheat Producers' Marketing Board or the Nova Scotia Wheat Producers' Marketing Board.

16.144 *The Department should reconsider the basic nature of its relationship with the various provincial wheat boards and develop an appropriate system for verifying figures they report.*

16.145 Audit of contributions. An Agreement of Acknowledgement and Undertaking signed by the Canadian Wheat Board indicates that the records prepared by the Board for the Hopper Car Program are open for departmental inspection. To date the Department has not conducted an audit of these records.

16.146 *The Department should request the Canadian Wheat Board to prepare an annual accounting of contributions and their disposition and that this accounting be subject to audit by the external auditors of the Canadian Wheat Board. The auditors should formally report to the Deputy Minister of the Department on the results of their examination.*

16.147 Section 10(3) of the Two-Price Wheat Act gives the Minister the authority to inspect the records, books, accounts and vouchers of every miller, processor, manufacturer, dealer or other person in Canada who purchases wheat for human consumption in Canada. We understand that regular financial audits are not undertaken on either the records of the millers or the records of the individual wheat boards by delegates of the Department.

16.148 *In view of the significance of grants and contributions payments under this program and the reliance being placed on effective systems of financial control in the boards, the Department should undertake regular audits at both the miller and the board levels. These audits might be arranged in such a way that there is participation by either the external or internal auditors of the respective wheat boards.*

Shipbuilding Industry Assistance Program

16.149 Introduction and scope. The objective of the program is to support the Canadian shipbuilding industry by subsidizing the cost of constructing vessels for Canadian or foreign registry. The program aims at promoting efficiency in ship construction by helping to maintain a constant production level. It was estimated that \$65 million in subsidies would be distributed to Canadian shipbuilders under this program in the year ended March 31, 1978.

16.150 Our examination comprised a review of 12 current subsidy contracts representing at the time 90% of all Shipbuilding Industry Assistance Program expenditures for the year.

16.151 Inadequate financial reviews. The Project Analysis Group of the Enterprise Development Branch performs a financial review of the shipbuilder involved before any decision on whether to grant a subsidy. The purpose is to ensure in advance that the shipbuilder has the financial capability to undertake the work.

16.152 The checklist used by the Project Analysis Group during financial reviews does not provide for standard financial review procedures. For example, It does not require financial statements, specify satisfactory financial ratios, or address the issue of financial forecasts.

16.153 *Financial review procedures should be standardized to ensure consistency and completeness in the financial review of all applications by shipbuilders.*

16.154 Limitation of commitment authority. The Director of the Transportation Industries Branch signs under Section 25 of the Financial Administration Act to commit the Department to expenditures under the Shipbuilding Industry Assistance Program. He also signs the formal subsidy agreement with the shipbuilders. During the current year, he signed one certification which committed the Department to disburse funds of \$45 million to a single applicant. In spite of the size of this commitment, no other signature was necessary to bind the Department to the agreement. Considering the significance to the Department of the amount involved in this single commitment, one must question the reasonableness of the extent to which authority was delegated in this instance.

16.155 *Major commitments should be signed by the Assistant Deputy Minister responsible for the Shipbuilding Industry Assistance Program.*

Promotional Projects Branch - Fee Revenue

Unauthorized Charging of Fees

16.156 The Department participates on behalf of the Canadian Government in trade fairs in foreign countries, organizes trade missions and sponsors trade visitors to Canada. It assesses a fee to each company participating in a trade fair, based primarily on the floor space which the company anticipates occupying. This performance fee is charged so that if the company withdraws, the Department will recover some of the costs it incurred. Fees of about \$250,000 collected each year are recorded temporarily in a suspense account rather than being credited immediately to non-tax revenue.

16.157 Section 13 of the Financial Administration Act empowers the Governor in Council, on the recommendation of the Treasury Board, to prescribe fees and charges for services or to authorize Ministers to prescribe fees and charges for programs. In order to obtain this latter authority, departments are required to submit to the Treasury Board a proposed scheme under which their Minister would set fees and charges. The Department has not obtained the necessary approval for charging these fees.

16.158 *The Department should immediately prepare a submission to the Treasury Board to obtain authority for continuing to charge fees to participants in trade fairs.*

Unauthorized Spending of Receipts

16.159 As part of its assistance, the Department reimburses a portion of the air fare incurred by company officials travelling to trade fairs and subsidizes the transportation of exhibits and equipment. It pays these reimbursements out of the suspense account referred to above.

16.160 Section 11 of the Financial Administration Act requires that all public money received be deposited to the credit of the Receiver General. However, Section 14 of the Financial Administration

Act permits money received "as a deposit to ensure the doing of any act or thing" to be held or disposed of by the department concerned.

16.161 The Department holds these fees in suspense and spends a portion of them because it believes that they fall under Section 14. The present situation is confusing and is a potential problem area as the purpose and use of the fees is not clearly defined and authorized.

16.162 *The Department should immediately prepare a submission to the Treasury Board to clarify and obtain ratification of its current practices of using performance fees to reimburse companies participating in trade fairs for a portion of their transportation costs.*

Follow-up of Previous Years' Recommendations

16.163 With the following exceptions, the Department has taken the necessary corrective action on recommendations this Office made in previous years.

16.164 *Financial and administration officers outside Financial Services Branch should report functionally to a senior financial officer. (Supplement to the 1975 Report, page 199).*

16.165 The Department maintains that functional direction by senior financial officers currently takes place, but on an informal basis. The Department further states that the functional reporting relationship to senior financial officers will be formalized in the near future.

16.166 *A specific timetable should be developed for completing the departmental financial manual as soon as possible. Supplement to the 1975 Report, page 200).*

16.167 The completion date given by the Department in their published response to this issue was December 31, 1975. At the present time, the manual does not contain sections dealing with:

- procedures for financial planning and the preparation of program forecasts;
- procedures for the preparation of the Estimates;
- guidelines for budget preparation, allocation and control;
- methods of cash forecasting;
- procedures to be followed in controlling contribution programs involving other federal departments or agencies; or
- the role and responsibilities of the senior financial officer and the responsibilities for financial administration and control by officers at the responsibility centre or program level.

The Department has now revised its timetable and anticipates that the manual will be completed by March 31, 1979.

16.168 *A further review should be made of DSS services so as to minimize, as much as possible, the duplication that exists between the Department of Industry, Trade and Commerce and DSS in data preparation for the reporting systems. (Supplement to the 1975 Report, page 201).*

16.169 The duplication between the Department of Supply and Services (DSS) and the reporting systems used by departments for management purposes is a government-wide problem. The Department has held discussions with DSS aimed at exchanging data in machine-readable form to reduce duplication in processing information, but found this impractical at the present time for technical reasons.

Summary of Recommendations and Department's Comments

Recommendations

Organization and Role of the Financial Function

16.18 A review should be made of the responsibilities assigned to the Director General, Finance and Administration, to ensure that non-financial duties do not unduly hamper his ability to carry out his responsibilities as the Department's senior financial officer.

Department's Comments

This is of continuing concern to departmental management and will be reviewed in the light of overall departmental priorities during 1978-79.

Recommendations

16.20 The senior financial officer should develop and issue instructions on aspects of financial administration and control carried out by employees who do not have full-time financial responsibilities.

Department's Comments

Policies identifying the Senior Financial Officer's responsibilities for functional direction have been approved by the Management Committee. Instructions will be incorporated into the Finance Manual.

Recommendations

16.22 The senior financial officer should assign specific individuals to continue to develop and implement the Operational Performance Measurement System.

Department's Comments

Agreed. Steps are being taken to assign an officer to co-ordinate the Department's efforts in this area.

Recommendations

Machinery Branch - Management Controls

16.35 The Department should aim at making quantitative evaluations of all of its department-wide programs. The Machinery Branch should strive to extend the application and use of activity and effect monitoring for sectoral strategies and the advisory and service assistance it provides to the Machinery Sector.

Department's Comments

The department-wide programs commented on by the Auditor General have now been revised or terminated following the audit carried out in 1976-77. The new department-wide program is the Enterprise Development Program. Responsibility for the quantitative evaluation of this program has been assigned to branches responsible for the management and assessment of the Enterprise Development Program.

The monitoring and assessment of "sector strategies" (Sector Profiles and Action Plans) will be carried out by and be the responsibility of the respective line managers. Sector Profiles and Action Plans, which are currently under development, will be monitored when approved by the Cabinet.

Recommendations

16.38 The Machinery Branch should investigate the consequences of incomplete and inaccurate information in its data bank on Canadian machinery manufacturing capabilities, determine appropriate standards of completeness and accuracy and take necessary steps to meet these standards.

Department's Comments

In the ten years since the inception of this Program, there has been no evidence of any serious consequences affecting either importers or manufacturers unfavourably, because of possible inaccuracies or incompleteness in the data bank. (Re-submissions are less than one per cent of Applications)

A current study by outside consultants of the administrative procedures pertaining to this tariff remission program will provide further evidence as to whether there is a need to improve present standards of completeness and accuracy to reflect the dynamic changes in Canadian machinery manufacturing capabilities.

Recommendations

16.40 The following procedures should be introduced on a temporary basis to determine their economic advantage:

- the number of application re-submissions should be reported and the causes analysed; and
- the number of complaints and inquiries from applicants about their applications should be reported and categorized as to their causes.

Department's Comments

As a matter of formal procedures under this Program, each re-submission is reviewed individually by the Machinery and Equipment Advisory Board as to its causes and consequences. Similarly, complaints and inquiries are monitored on an ongoing basis by the Secretariat to the Board. However, no formal report is prepared on these aspects of the Program since no problem has arisen in this connection. Nevertheless, the Branch will initiate, on a temporary basis, a more formalized reporting system as suggested.

Recommendations

Internal Audit

16.47 The head of internal audit should report directly to the Deputy Head.

Department's Comments

Consideration will be given to this recommendation as the independence of the audit function is naturally of continuing concern to the Department. However, the need for a direct reporting relationship to the Deputy Minister must be considered in the context of the Departments overall organization.

Recommendations

16.51 The Audit Committee should meet as soon as possible to establish written terms of reference for itself and to review, challenge and approve the 1978-79 internal audit plan.

Department's Comments

Agreed. The Audit Committee met in July 1978.

Recommendations

16.54 A model of the Department and related agencies should be prepared, showing all programs and activities that can be considered as potential audit candidates, as a basis for developing an internal audit plan. The model should be updated at least annually.

Department's Comments

Agreed. Steps are being taken to implement this recommendation.

Recommendations

16.57 The Office of Departmental Review should develop a policy which clearly establishes the criteria to be used in selecting possible audit areas and the timing and the extent of work to be completed.

Department's Comments

Agreed. Steps are being taken to implement this recommendation.

Recommendations

16.59 The audit plan should be supported by an individual memorandum on each assignment detailing the areas and issues to be addressed and the estimated audit time by audit function.

Department's Comments

Agreed. Steps are being taken to implement this recommendation.

Recommendations

16.61 The Audit Branch should formalize its procedures, programs and practices and develop a comprehensive internal audit manual.

Department's Comments

Agreed. A comprehensive internal audit manual is under development. Because of the relative newness of the Office of Departmental Review and the internal audit function in Industry, Trade and

Commerce, it was decided that such a manual should not be finalized before the function had a chance to prove itself operationally. It is now planned that the audit manual will be completed by Spring 1979.

Recommendations

Budgetary Control

16.69 Executive guidelines or priorities should be communicated in writing, supplemented by discussions at each stage of the budgetary process, to ensure consistent interpretation.

Department's Comments

Agreed. This will be implemented during the Work Program Process.

Recommendations

16.71 The Department should develop a long-term (e.g., five-year) plan which would identify intermediate goals and points of decision and would allow monitoring of progress towards longer range objectives.

Department's Comments

While such a requirement is not called for by the guidelines set out by the Treasury Board, it will be given serious consideration during 1978-79.

Recommendations

16.73 Senior management should reinforce the Department's commitment to the work program system as an essential ingredient in the system of budgetary control by insisting that work programs be prepared in a manner that will ensure compliance with the system's purpose.

Department's Comments

Agreed, this will be implemented during 1978-79.

Recommendations

16.75 Challenge committees should be established under each Assistant Deputy Minister to review work programs in detail, and financial officers assigned to programs should be members of these committees.

Department's Comments

The feasibility of separate challenge committees and their membership will be assessed during 1978-79.

Recommendations

16.77 Operating budgets should be prepared by month or quarter, so planned and actual results can be compared and changes in anticipated spending patterns can be detected immediately.

Department's Comments

This recommendation will be given serious consideration.

16.79 Responsibility Centre Managers should be required to report at least annually on the results produced by each of the jobs included in their work programs and to explain differences between actual and anticipated results. Summarized versions of these reports would provide a useful means for Assistant Deputy Ministers to report to the Deputy Minister.

Department's Comments

The mid-year review is in our view a more effective reporting opportunity as it permits modification and adjustment. In future, reporting every quarter may be introduced.

Recommendations

16.81 A program review process should be instituted by internal audit to ensure that branches are expending resources for the purposes indicated when budgets were approved.

Department's Comments

This has been introduced and is the starting point for audits of individual Branch Activities.

Recommendations

Financial Reporting

16.86 To ensure that work programs represent an effective control mechanism, actual costs should be captured and reported on the same basis as work programs are prepared.

Department's Comments

Costs will be captured by practical work program levels.

Recommendations

16.88 Actual program outputs should be reported in relation to planned outputs to assess whether objectives are being met and to facilitate corrective action.

Department's Comments

Agreed, the introduction of regular reports of outputs will be introduced during 1978-79.

Recommendations

16.90 A variance analysis system should be developed requiring managers to explain significant variances in actual costs and outputs from the budget.

Department's Comments

Agreed. Variance reporting procedures will be developed during 1978-79.

Recommendations

16.92 Training in the use and interpretation of financial reports should be a vital element in the orientation of new managers and in refresher courses for existing managers.

Department's Comments

Agreed.

Recommendations

16.95 Action to improve the centralized commitment accounting system should be continued. Once it is operational, the maintenance of commitment records within branches should be strongly discouraged by senior management.

Department's Comments

Such a system is in the final stages of implementation. Once implemented and proven fully satisfactory, other systems will be discontinued.

Recommendations

Electronic Data Processing

16.100 The Department should create an executive Electronic Data Processing steering committee to approve annual and long-range plans and to determine and establish priorities for the Department's Computer Processing activities.

Department's Comments

This recommendation will receive further consideration as the department systems and data processing responsibilities and organization evolve during 1978-79. For the present, although a formal EDP Steering Committee does not exist, the Director General, Finance and Administration, performs the preliminary review function. Major EDP projects are submitted for approval to the Department's Management Committee.

Recommendations

16.102 Senior officials of the Department should inform Department of Supply and Services that security clearance has not been obtained for the service bureaus processing its data and that one should be completed as soon as possible to ensure the confidentiality of information.

Department's Comments

This has been done. The Royal Canadian Mounted Police conducted a formal audit and inspection of the data processing centre at Industrial Life Technical Services Inc. (IST) on February 28 through March 2, 1978. A verbal report received on March 2 indicated no problems were encountered.

Recommendations

16.104 Procedures for off-premises storage should be formalized, implemented and enforced. These procedures should encompass all critical machine-readable files, instructions, standards manuals and other critical documentation.

Department's Comments

Agreed. A secure off-site storage service is available for tape and disk files requiring a higher level of security and protection against fire, theft or unauthorized access.

Recommendations

16.106 The Department should develop a computer equipment back-up plan to encompass all processing facilities, equipment, files and documentation.

Department's Comments

Agreed. IST utilizes the services of Canadian Data Protection, an organization that has been security certified. All our production libraries are periodically copied onto tapes and stored in IST's off-site facilities. IST has made continuing arrangements with the Data Centre of IBM Canada Ltd., Montreal, such that their computing facilities can be used in the event of a disaster. Consistent with Management Systems Division (MSD) plans, contingency plans will be defined in MSD's new Standards and Guidelines Manual.

Recommendations

16.108 Projects to update existing systems documentation and procedures manuals should be completed and compliance should be enforced.

Department's Comments

The MSD Standards and Guidelines have been rewritten and will be implemented in 1978. Compliance is enforced by the Project Management area of MSD, but this role will be assumed by the Quality Assurance group when it is formed later this year.

Recommendations

16.110 All programs, systems and program documentation should be under the control of a librarian.

Department's Comments

All production libraries are under the control of the Technical Support group of MSD. Prior to the physical move of "test libraries" to "production libraries", a detailed review is carried out by the Technical Support group of all documentations which must conform to established standards before being moved to the production mode. The latter function will be taken over by a Quality Assurance group which will be created within MSD, as a reorganization and realignment of duties is effected later this year.

Recommendations

16.112 To provide more effective internal control, responsibility for certain closely related functions in the Management Systems Division should be adequately segregated, particularly in the area of Financial Systems.

Department's Comments

The position of Data Base Administrator has been created and the Quality Assurance group will be established later this year. The other roles listed exist and will be more visibly separated with the aforementioned reorganization of MSD.

Recommendations

16.114 Procedures in the Department's Administrative Manual relating to user group involvement in Electronic Data Processing activities should be complied with and enforced.

Department's Comments

Agreed. All new EDP projects must adhere strictly to the established procedures of having client users sign off at the end of each phase of the system's development life cycle.

Recommendations

Grants and Contributions

16.121 Until suitable trained financial analysts are on site at each regional office, the Program Analysis Group should monitor the financial analyses at each regional office.

Department's Comments

Procedures are in place for the monitoring and review of submissions by the Enterprise Development Branch. A review of existing monitoring and review procedures is being undertaken. These procedures will be modified as necessary.

Recommendations

16.126 Senior officials of the Department should ensure that potential recoveries under the PAIT I program are analysed, policy issues are resolved and negotiations with all assisted companies are concluded as quickly as possible.

Department's Comments

Agreed. This work is ongoing.

Recommendations

16.130 All projects in the holdback liability account should be reviewed and followed up and appropriate reports prepared for senior management.

Department's Comments

Projects in the holdback account are reviewed and followed up. Provision has been made to produce holdback reports to facilitate follow-up action and permit a clear indication of what follow-up action is taken.

Recommendations

16.132 Appropriate criteria should be developed for selecting and timing audits of contributions under this program.

Department's Comments

All projects are audited when completed and reviews are made of company systems and records on large projects. Criteria will be established to identify those projects requiring interim reviews.

Recommendations

16.135 The Department should discuss with the Treasury Board Secretariat and the Office of the Comptroller General improved disclosure of the financial operations of the loan insurance program in the Estimates and the Public Accounts.

Department's Comments

Alternative ways of reporting will be explored.

Recommendations

16.142 A memorandum of understanding should be prepared defining the responsibilities, duties, delegations of authority and detailed operating procedures of all parties involved in administering grants and contributions under the Grains and Oilseeds Program. Special emphasis should be placed on all aspects of financial management and control.

Department's Comments

This is being developed.

Recommendations

16.144 The Department should reconsider the basic nature of its relationship with the various provincial wheat boards and develop an appropriate system for verifying figures they report.

Department's Comments

This will follow the Memorandum of Understanding.

Recommendations

16.146 The Department should request the Canadian Wheat Board to prepare an annual accounting of contributions and their disposition and that this accounting be subject to audit by the external auditors of the Canadian Wheat Board. The auditors should formally report to the Deputy Minister of the Department on the results of their examination.

Department's Comments

This request will be drawn to the attention of the Chairman of the Wheat Board.

Recommendations

16.148 In view of the significance of grants and contribution payments under this program and the reliance being placed on effective systems of financial control in the boards, the Department should undertake regular audits at both the miller and the board levels. These audits might be arranged in such a way that there is participation by either the external or internal auditors of the respective wheat boards.

Department's Comments

Payments under the Two-Price Wheat Program are made on the following basis:

1. Canadian Wheat Board
 - Individual claims are certified by external auditors.
2. Ontario Wheat Producers Marketing Board
 - Claims received are subject to adjustments through the audit carried out by external auditors annually.
 - An audit was last carried out by Financial Services Branch in February 1977.
3. Quebec Producers and Nova Scotia Wheat Marketing Board -
 - The amounts claimed by the producers are verified to the amounts reported by the agents and these in turn are verified to the amounts reported by the millers.
 - In 1976 Financial Services Branch carried out an audit of the Quebec Producers.

The need for additional audits by the Department will be looked into and provided for in the audit plan as required.

Recommendations

16.153 Financial review procedures should be standardized to ensure consistency and completeness in the financial review of all applications by shipbuilders.

Department's Comments

Standard review procedures will be available by September 1, 1978.

Recommendations

16.155 Major commitments should be signed by the Assistant Deputy Minister responsible for the Shipbuilding Industry Assistance Program.

Department's Comments

With very few exceptions, all ship commitments are "major". It is felt that delegation at the Director level is, considering the nature of the program, appropriate.

Recommendations

Promotional Projects Branch - Fee Revenue

16.158 The Department should immediately prepare a submission to the Treasury Board to obtain authority for continuing to charge fees to participants in trade fairs.

Department's Comments

The amount collected is not considered a fee but the reimbursement of a share of the fair costs. The Department is, however, preparing a Treasury Board submission to clarify this issue.

Recommendations

16.162 The Department should immediately prepare a submission to Treasury Board to clarify and obtain ratification of its current practices of using performance fees to reimburse companies participating in its trade fairs for a portion of their transportation costs.

Department's Comments

A Treasury Board Submission will be prepared.

<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Department of National Health and Welfare</H1>
</CENTER>

<HR>

Summary of Findings, Observations and Recommendations

Introduction

Departmental Overview

17.1 Resource. The staff and financial resources associated with the Department of National Health and Welfare for the year ended March 31, 1978, can be summarized as follows:

Man-years		(millions of dollars)	
<u>1977-78</u>		<u>1977-78</u>	<u>1976-77</u>
	Department - Expenditures		
3,213	Income Security and Social Assistance	8,086	7,577
246	Health Care	2,771	3,077
3,932	Medical Services	143	127
2,131	Health Protection	72	72
124	Fitness and Amateur Sport	26	30
<u>510</u>	Administration	<u>15</u>	<u>14</u>
10,156		<u>11,113</u>	<u>10,897</u>
<u>40</u>	Medical Research Council - Expenditures	58	52
<u>10,196</u>		<u>11,171</u>	<u>10,949</u>
	Canada Pension Plan Account		
	Balance - beginning of year	11,357	9,770
	Contributions	1,846	1,684
	Interest income	921	777
	Benefit payments	(1,059)	(833)
	Administration	<u>(46)</u>	<u>(41)</u>
	Balance - end of year	<u>13,019</u>	<u>11,357</u>

17.2 Some background observations on this information are:

- this Chapter treats Income Security and Social Assistance as separate programs since they are administered by separate branches and differ substantially in character;
- significant changes have been made in recent years to the federal-provincial arrangements that govern the Social Assistance and Health Care Programs with the result that financial information as reported in the accounts is not directly comparable from year to year;

- Fitness and Amateur Sport also had expenditures in 1978 of \$4 million financed from revenues received by the Treasury Board from Loto Canada.
- the executive head of the Medical Research Council does not report to the Deputy Minister of National Health and Welfare; and
- the Canada Pension Plan Account is reported as a separate accounting entity and is therefore excluded from the expenditures, revenues and accounts of the Government of Canada. Responsibility for administering the Plan rests primarily with the Income Security Programs Branch of the Department working with the Departments of Supply and Services, Employment and Immigration, Insurance and Finance. The Department of National Revenue-Taxation has responsibility for the coverage of persons and collection of contributions.

17.3 Organization of the Department. The Department has an Executive Committee made up of the Deputy Minister; three other officials; six program Assistant Deputy Ministers; and the Assistant Deputy Ministers of Administration, Intergovernmental and International Affairs and Policy Research and Planning. This expands into the departmental Management Committee with the addition of approximately 12 other officials generally representing staff functions including the Director General, Financial Administration. Approximately 14 officials report directly to the Deputy Minister not including officials who have a functional reporting relationship to the Deputy Minister, such as the Director General, Financial Administration and the Director of Internal Audit, and officials of external groups including the Office of the Auditor General.

17.4 In 1976-77, the Department was consolidated under one Deputy Minister. The Department is now rationalizing the organization and integrating the Health and Welfare components. Additional organizational changes have been made, most recently in July 1978, which have had some impact on the content of most of the major programs.

17.5 The Department is also gradually integrating the programs for paying benefits to the public with the objective of improving service and realizing economies. During 1977-78, the administration of the Old Age Security and Family Allowance payments was consolidated with the administration of the Canada Pension Plan under one Assistant Deputy Minister responsible for all the Income Security Programs. Plans are being developed for decentralizing and integrating Canada Pension Plan processing with the regional Income Security offices and for integrating public liaison activities through local services offices of the Canada Pension Plan.

Summary of Audit Office Activities

17.6 Scope of the audit. We designed our 1977-78 audit to continue the impetus of the special audit projects of recent years and to integrate these concepts into our regular audit activities. Special projects of prior years include the Financial Management and Control Study (1975-76), Accommodation (1975-76), the Computer and Information Systems Evaluation (1976-77), the Receipt and Deposit of Public Money (1976-77) and Travel and Removal (1976-77).

17.7 This year there were four department-wide areas of interest: the role of the financial function; the information submitted to Parliament; the internal audit function; and payroll controls. Functions such as budgetary control and financial reporting were not dealt with on a department-wide basis.

17.8 Other audit activities were organized into program-based projects to consider all aspects of financial control within the major programs or program components. We did not examine the Administration and Health Protection Programs and some financially less material elements of other major programs, such as Public Service Health, Welfare Information Systems and New Horizons. Controls and records in the major computer systems were examined and tested in more depth than in the past. We performed substantial field work to support the audit opinions given on the Financial Statements of Canada and on the financial statements of the Canada Pension Plan and the Medical Research Council.

17.9 Value-for-money examinations were generally omitted from the scope of the audit, but we did review an established performance measurement system for the Family Allowance and Old Age Security benefits processing activities and we also initiated general inquiries as to the adequacy of available financial or non-financial information for monitoring performance in several other programs.

17.10 Reliance placed on internal audit. Staff of the Audit Office coordinate our audit plans with the Department's own internal audit group to avoid unnecessary omissions or duplications in effort.

17.11 This year we specifically reduced the scope of our audit and relied on internal audits of the Health Protection Branch and certain regional offices in the Income Security Programs and Medical Services Branches. Internal audit identified and reported weaknesses in the financial controls. We reviewed their reports and evidence that corrective action is being planned.

Highlights of the Audit Observations

17.12 Audit observations in this Chapter reflect the results of a systems-based audit approach that involves four main steps:

- examination of the strengths and weaknesses in the financial systems;
- determining the extent that controls can be relied on;
- drawing weaknesses to the attention of management; and
- performing detailed substantive investigations to assess the consequences of weaknesses where feasible.

17.13 This Chapter attempts to give a balanced perspective of the strengths and weaknesses of the Department's financial systems, but necessarily gives greater details of weaknesses. These do not, in themselves, indicate any impropriety in the handling of public funds. Our audit did not identify any significant or conclusive misappropriation of funds, but substantive investigations did identify errors and lapses in control. They also revealed a lack of appropriate checks, balances, segregation of duties, information and monitoring procedures that would provide a sound basis for relying on the systems and on the financial advice provided to the Deputy Minister and senior managers. In all cases managers have demonstrated confidence and reliance in their senior staff, concern over identified weaknesses and errors and a genuine desire to take effective corrective or preventive action. All the Branches have plans for improving their systems.

17.14 Details of our audit activities, findings and recommendations reported to appropriate levels of departmental management have been summarized in this Chapter. The following paragraphs highlight our observations on each major area of audit interest.

17.15 Role of the financial function. Revised responsibilities and organizational changes have enhanced the role of the financial function, but there is still significant scope and need for improvement in the clarification, definition, performance and acceptance of the role of the financial function.

17.16 Financial information received by Parliament. The departmental financial information presented in accordance with the standard government-wide form in the Estimates and Public Accounts provides little practical indication of program content, significant expenditure trends or the way in which programs are managed and controlled.

17.17 Internal audit. A potentially strong, progressive internal audit function has had little involvement in the major computer systems and in the major grants and contributions programs.

17.18 Canada Pension Plan financial arrangements. The need for continuing review of the appropriateness of the present financial arrangements of the Canada Pension Plan is evident from the information reported by the Department in the Notes to the Financial Statements of the Plan included in Volume II of the Public Accounts.

17.19 Canada Pension Plan contributions and benefits controls. Major initiatives are planned to correct and compensate for control weaknesses in the maintenance of computer systems and in accounting for contributory earnings of individuals. Subject to these weaknesses the related, but separate, systems for paying pension benefits are adequately controlled.

17.20 Family Allowance and Old Age Security - Benefits controls. The systems for the payment of Old Age Security and Family Allowance Benefits are adequately controlled except for minor weaknesses in the manual controls that are unlikely to lead to material errors.

17.21 Family Allowance and Old Age Security - Performance Measurement. The system of measuring the relative performance of regional offices administering the Old Age Security and Family Allowance Benefits is satisfactory.

17.22 Canada Assistance Plan. Until the major program changes now being implemented or planned are reflected in provincial accounting and control systems, there will be significant difficulties in establishing reliable and effective financial controls in the administration of the Canada Assistance Plan.

17.23 Health Care. The final settlement of accounts with the provinces for Hospital Insurance and Medical Care, under the shared-cost arrangements that terminated March 31, 1977, will require several years. From April 1, 1977, for at least a five-year period, cash contributions and income tax points are being transferred to the Provinces under new, complex Federal-Provincial fiscal arrangements. As a result, payments allocated to this Department and to Post-Secondary Education could be more comprehensively displayed and explained in the Estimates and Public Accounts.

17.24 Medical Services. There are plans to address some of the program elements that are the most difficult to manage and control effectively; to correct numerous detailed weaknesses identified in many regional offices and treatment centres; and, to provide improved information to managers by reorienting financial reporting to complement a new performance measurement system.

17.25 Fitness and Amateur Sport. In the last year major initiatives were taken to improve serious inadequacies in program and financial management and to follow up on contributions not adequately

accounted for by recipients. A comprehensive systems improvement program is being implemented, the success of which will depend on the continuing support of all senior staff.

17.26 Payroll. The adequacy of payroll controls is inconsistent among the Branches. The best locations provide an adequate base for developing a well controlled payroll system, but stronger central direction and numerous technical improvements are required to improve cost information and eliminate current opportunities for undetected error.

17.27 Grants and Contributions for National Welfare, Family Planning and National Health Research and Development. A number of minor weaknesses and inconsistencies in control illustrate the need to ensure that there is an effective, independent review and monitoring function over the Department's smaller grants and contributions programs.

17.28 Medical Research Council. There are good controls over the payment of grants and scholarships.

Role of the Financial Function

Background

17.29 Management responsibility generally has been delegated to the heads of the major programs and, within each program, to the heads of regional offices and operational directorates. Each major program has its own combination of administrative, financial, personnel and other functional support staff at program headquarters and in some cases in regional offices and directorates. Responsibilities are therefore highly decentralized for most aspects of financial management including systems design, planning and budgeting, initiating and processing transactions and analysing financial and performance information. This devolution of responsibilities reflects a desire to reinforce the authority and responsibility of line managers and is consistent with the vastly differing nature of the major programs and the differing operating conditions among Directorates and Regions.

17.30 Our 1975-76 study of financial management and control in the Department focused on the staffing, training, responsibilities and reporting relationships of the full-time financial officers throughout the Department and on the functional leadership given to program managers and others with financial responsibilities. We observed that financial officers had not played an adequate role in management; had little involvement in reviewing and evaluating the financial controls relating to the statutory and annually voted contributions; and were not adequately monitoring the application of financial systems and procedures. A number of recommendations were made to clarify and strengthen the role of the financial function. The recommendation that seemed to cause the Department the most difficulty called for the appointment of a Senior Financial Officer who would report directly to the Deputy Ministers and be a member of the Departmental Executive Committee.

Scope of the Audit

17.31 In each major audit project in the Department, we considered the appropriateness of the role played by financial officers in the management of the Department and the program. We examined a draft policy statement on the role of the Director General, Financial Administration and the Branch Senior Financial Officers but did not re-examine in detail other aspects of the reporting relationships, staffing arrangements and training needs throughout the financial function.

Strengths

17.32 Subsequent to the Financial Management and Control Study in 1976, personnel and organizational changes have affected almost every key financial position. For example:

- there have been four changes of personnel in the position of Assistant Deputy Minister of Administration, four changes in Director of Internal Audit and changes in Director General of Financial Administration, Divisional Chiefs within the Financial Administration Directorate and senior financial officers of most branches. Several key appointments have been made since March 31, 1978;
- more comprehensive position descriptions with higher classification levels were developed for the Assistant Deputy Minister, Administration and for the Director General, Financial Administration;
- a financial officer has been assigned, on behalf of the Branch Senior Financial Officer, to participate in developing and monitoring the application of controls in the major computerized systems of the Income Security Programs Branch; and
- policies and procedures have been adopted to implement recommendations for stronger functional relationships between the Director General of Financial Administration and Branch Senior Financial Officers.

We believe these changes and appointments will result in more stability and continuity and that the financial function is now in a position to make a more significant contribution to departmental management.

17.33 The senior financial officer of the Department is the Assistant Deputy Minister, Administration. This position has been given new responsibilities that place primary emphasis on his role as the principal adviser to the Minister and the Deputy Minister on all resources management matters. It is a comprehensive, unrestricted role that provides for him, as a member of the Departmental Executive Committee and various policy committees, to give leadership and direction in:

- analysing and evaluating costs and benefits relating to legislative proposals during formulation stages;
- analysing and evaluating new program impact on internal manpower, financial and other resources; and
- implementing review and evaluation concepts and systems in the Department.

17.34 A new draft administrative policy directive defines the proposed role of the Director General, Financial Administration as the senior full-time financial officer and companion policies are being developed to clarify the role of the Branch Senior Financial Officers. This policy is a carefully worded attempt to ensure that the Director General will provide a focal point for co-ordination and leadership of the financial function without in any way diminishing the responsibility of the branch heads for the management of their programs or of the Assistant Deputy Minister, Administration. The Director General reports to the Deputy Minister on an exception basis on any matter that in his judgment warrants such action. He is responsible to the Assistant Deputy Minister, Administration for managing departmental financial administration. The policy provides for his involvement in staffing and appraising

the performance of the financial function in the branches; in establishing and monitoring policies and standards of financial administration and performance measurement; and in assembling financial information and providing financial advice.

Areas for Improvement

17.35 Our purpose in reviewing the new organizational arrangements is to assess the extent to which they provide a reliable basis for ensuring that senior management is being supplied with comprehensive financial advice. However, the new policies on the roles of the Assistant Deputy Minister, Administration, the Director General, Financial Administration and the Branch Senior Financial Officers have not been in place long enough to determine how they will be interpreted and applied in practice and whether they will prove effective.

17.36 The Assistant Deputy Minister, Administration has other major responsibilities in addition to being the senior departmental financial officer. For example, he is responsible for:

- developing and implementing public information programs, a major operational responsibility in this Department;
- approving and implementing administrative organizational structures for the branches and directing the recruitment and development of senior professional, managerial and support personnel within the branches;
- establishing departmental policy in the areas of finance, personnel, official languages, public information and administrative services; and
- managing the Administration Program with over 500 persons and \$14 million in annual expenditures in seven Directorates including Personnel Administration, Financial Administration and Internal Audit.

With such a heavy involvement and direct responsibility for a broad range of administrative policy and the delivery of services, it may be difficult for the Assistant Deputy Minister, Administration to provide and to be seen to provide the objective and comprehensive financial advice to management expected of a senior financial officer.

17.37 The present Assistant Deputy Minister, Administration -- an experienced program manager, personnel and administrative officer -- will need support from particularly strong and reliable financial and internal audit functions with comprehensive responsibilities to reflect his role as the principal adviser in areas of resource management. To achieve that objective there is still significant scope and need for improvement in the clarification, definition, performance and acceptance of the role of the financial function.

17.38 Time will be required to determine the extent to which new organizational arrangements can be effective. However, we are concerned that the Department does not have a senior officer with the role envisaged for Departmental Comptrollers in Chapter 8 and supported by statements of the President of the Treasury Board and conclusions of the Public Accounts Committee.

17.39 Clarification and definition of the role of the financial function. The organizational arrangements, position descriptions and draft policies still contain ambiguities relating to the role of the Assistant Deputy Minister, Administration and some of his key officers. Our concern is that some of the possibly

minor ambiguities may ultimately prove to be indicative of more fundamental weaknesses in the interpretation of the role of the financial function in general and of the Assistant Deputy Minister, Administration in particular. For example:

- the position description of the Assistant Deputy Minister, Administration indicates that he is responsible for implementing review and evaluation concepts and systems in the Department, but only the more restricted concept of operational effectiveness is now provided for in the responsibilities of the Financial Administration and Internal Audit Directorates, and these Directorates have limited staff capability in this area. We understand that the omission of any provision for the concept of program effectiveness evaluation is intentional as the assignment of responsibility for the function has not yet been decided;
- the Assistant Deputy Minister, Administration should, in our view, be expected to provide comprehensive financial advice on major grants and contributions programs. However, only a restricted concept of advice on matters of financial control is provided for in the responsibilities of the Director General, Financial Administration and Internal Audit has not been active in this area. When this point was raised with the Department, we were told that advice on the timing, quantum and conditions of the payments under these programs, as opposed to financial controls, is a matter of health or social policy that is beyond the scope of the Senior Financial Officer's role;
- it did not appear to be generally understood or accepted that financial officers are expected to examine the branch heads' analyses and explanations of program objectives to determine whether they are realistic and explicit enough to provide a basis for financial planning, financial reporting, performance and effectiveness measurement. It is the Department's view that although this responsibility may not be detailed in the policy statements on the roles of the Director General, Financial Administration or the Director of Internal Audit, and may not have been performed extensively in the past, it is considered to be inherent in their responsibilities dealing with performance measurement; and
- there are no guidelines in the responsibilities of financial officers in the branches to indicate when they should seek the advice of the Assistant Deputy Minister, Administration, particularly if they become aware of contentious matters such as major weaknesses in control or cases where expenditures may have been made or are going to be made other than for the purposes intended, without proper authorization or without due regard to economy and efficiency. The Department believes that the right to seek such advice is implicit in the description of the branch financial officer's relationship with the Director General, Financial Administration, but that it is purely a matter of judgment on the part of branch financial officers and hence, not a subject on which the enumeration of criteria is appropriate.

17.40 The senior full-time financial officer -- the Director General, Financial Administration -- is not a member of the Executive Committee and may not have the authority or status, as an equal member of the executive group, to examine and comment objectively on the costs, financial plans and performance of the Assistant Deputy Ministers and of the central administrative functions. The process of establishing and maintaining financial accountability of managers within the Department may, therefore, require more active monitoring by the Deputy Minister than would be the case if the senior

full-time financial officer had a reporting relationship equal to that of branch heads and was a member of the Executive Committee.

17.41 *The role of the financial function should be clarified and the implementation of the newly established policies closely monitored to ensure that:*

- *they are appropriately interpreted and applied in practice;*
- *the Assistant Deputy Minister, Administration, is able to perform the functions of senior financial officer effectively; and*
- *the responsibilities, organizations and staff of the Director General, Financial Administration and the Director of internal Audit fully support the responsibilities of the Assistant Deputy Minister, Administration and enable him to provide comprehensive, objective advice on departmental resource management.*

17.42 *The appropriateness of the existing organizational arrangements should be subject to a comprehensive review after a suitable trial period.*

17.43 Performance of the financial function. Financial officers are devoting most of their time and attention to the prime functions of:

- co-ordinating and administering the preparation of Program Forecasts, Main Estimates and other budgetary submissions for senior management and the Treasury Board Secretariat;
- assembling and analysing information affecting the availability of funds and man-years during the year;
- maintaining financial reports and accounting records;
- participating in staffing actions for financial and administrative positions;
- responding to specific evaluations and recommendations by Internal Audit, the Treasury Board Secretariat and the Office of the Auditor General; and
- authorizing and processing transactions in some cases.

17.44 Pressed to cope with daily matters, financial officers may not have had the time, staff resources or leadership to initiate major systems improvements and as a result have not established the systems to enable them to provide comprehensive financial advice to program managers and the Deputy Minister. The Director General, Financial Administration and others in the financial function have not, for example:

- developed a process for establishing and maintaining an intimate knowledge of the systems needs, problems and plans of the Branches in the area of financial management and control;
- been giving advice on the long-term financial and administrative implications for the major grants and contributions programs such as Family Allowance, Old Age Security, Canada Pension Plan and Canada Assistance Plan;

- made adequately visible in budgetary and financial reports the cash and non-cash costs of program policies and content as a basis for understanding costs and expenditure trends;
- provided sufficient help to managers in identifying their financial and performance information needs and establishing compatible systems and reports to meet these needs; nor have they actively participated in monitoring the performance information systems that are in place;
- ensured that there are adequate financial controls over computer systems;
- ensured that Departmental financial policies are as complete as practicable, adequately supplemented at the Branch and Directorate or Regional level and understood and applied in practice;
- participated in certain major management decisions with financial implications, such as the decision to integrate the administration of Family Allowance and Old Age Security with Canada Pension Plan benefits; and
- monitored controls over the identification and negotiation of differences and overpayments under the cost-sharing agreements with the Provinces.

17.45 The Department has not yet completed corrective action on recommendations included in the Financial Management and Control Study. New weaknesses are continuously being identified by Internal Audit and the Audit Office. In addition, all of the programs have identified the need for or have developed plans for major improvements to their financial management systems. Most of these plans are likely to require extra staff resources and two or more years to implement. The Director General, Financial Administration is monitoring reported actions in response to specific recommendations but has not been deeply involved in reviewing the broader needs, plans and priorities of the financial function in the Branches.

17.46 Financial officers, under the leadership of the Director General, Financial Administration, should develop a long-term strategy designed to:

- help managers identify their needs for financial and performance information;
- establish priorities and a comprehensive program to improve systems;
- ensure that budgetary and financial controls are in place;
- identify the time and staff resources and training required to implement and maintain the systems; and
- ensure that ultimately the financial function is in a position to provide comprehensive financial analysis and advice to management.

Such a strategy should be documented, communicated and reviewed with departmental management, Internal Audit and any central agencies potentially affected by the program including the Financial Reporting Services and Audit Services Bureau of the Department of Supply and Services. It should ultimately be approved by the Deputy Minister and subject to a project control and reporting system.

17.47 *A comprehensive plan should be developed to identify needs, establish priorities and make improvements to the financial management, control and performance measurement systems.*

17.48 Acceptance of the role of the financial function. The most important factor in the acceptance of a more significant role for financial officers in the management of the Department, will be their interpersonal and professional skills, the quality of their judgment and advice and the degree of support received from program managers. This is particularly important in the context of grants and contribution programs where they have not had significant involvement in the past.

17.49 To promote acceptance of the role of the financial function, it should be:

- seen to be supported by the executive group;
- documented more clearly and comprehensively; and
- communicated to the management and to other functional groups and all persons with financial responsibilities.

The title of Branch Senior Financial Officer is in the process of being introduced to replace the title Branch Financial Adviser. This title, along with those of the Assistant Deputy Minister, Administration and Director General, Financial Administration may not yet effectively communicate the combined advice, service and control responsibilities of these offices.

17.50 *To the extent that the role of the financial function may be better understood and accepted throughout the Department, consideration should be given to revising the titles of senior financial officers; the titles, Departmental Comptroller and Branch Comptrollers are suggested.*

Financial Information for Parliament

Purpose and Scope of Review

17.51 Our review was part of the broader study reported in Chapter 6 to consider and demonstrate alternative, improved methods of presenting financial information to Parliament as a means of contributing to studies of this subject by the Treasury Board Secretariat and as an aid to the Standing Committee on Public Accounts. We examined information prepared in support of Program Forecasts and Estimates, various annual reports required under the diverse statutes administered by the Department, other selected departmental publications describing program content, and other sources. The result of the project was a pro-forma set of departmental estimates for the 1978-79 fiscal year that illustrate a number of possible improvements. We believe these pro-forma estimates could be improved significantly with further study and greater departmental participation.

General Observations

17.52 Information that would provide a comprehensive and useful overview of the purposes to which funds are being applied, of historical and anticipated future expenditure trends and of the way in which programs are managed and controlled is not readily available from a single source and is in fact quite difficult to assemble. The standard government-wide form of Program Forecasts and Estimates tends to dominate all aspects of the financial information and reporting processes and determines the standards of analysis and involvement by financial officers. Present practices tend to emphasize objects of expenditure rather than program content, new expenditure increments rather than continuing

expenditures or expenditure trends, operations rather than grants and contributions, and man-years and funding levels rather than costs and performance information.

17.53 Grants and contributions. Information in the Estimates on each of the major grants and contributions is generally a brief identification of the program or reference to the relevant statute. These programs have significant financial implications for the future and represent the most material and variable proportion of departmental spending. The existing Estimates do not disclose to Parliament the major variable elements of program cost. Some of the variables would include various indexing factors, formulae, base-year data, cost-sharing agreements with other levels of government, discretionary interpretations as to eligibility and standards of service, commitments to minimum levels of funding, and delayed adjustments to or confirmations of the accuracy of amounts payable under agreements.

17.54 Information in the Estimates on the major grants and contributions programs could be significantly improved by including:

- descriptions of program content, eligibility for benefits and administrative arrangements;
- analysis of expenditures by recipient, type of recipient or service;
- more effectively integrated presentations of complementary programs such as Old Age Security and Canada Pension Plan;
- multi-year comparative cost data giving full and consistent effect to program changes, costs reflected in the expenditures of other departments, and costs of related income tax adjustments with other levels of government;
- long-term financial projections and analysis of historical and projected expenditure trends; and
- the assumptions underlying current and long-term forecasts.

We have supplied to the Department illustrative estimates incorporating these features.

17.55 Operations. The current program and activity presentations in the Estimates for operational expenditures of this Department is informative in terms of the stated program objectives. However, in every program, the presentation is either inconsistent with the responsibility for managing and controlling resources within the program or is presented at too high a level of aggregation to facilitate understanding and analysis of the major types of operations and their costs within the program. In most cases, organizational presentations below or in parallel with the defined activity structures are readily available within the Department and would significantly improve disclosure.

Internal Audit

Background

17.56 In 1977-78 the Department incurred direct costs of approximately \$500,000 on a centralized Internal Audit Directorate with 22 professional staff and a further \$200,000 on internal audit projects performed by the Audit Services Bureau.

17.57 The Department also paid approximately \$1,000,000 to the Audit Services Bureau for auditing contributions made under cost-sharing agreements with the Provinces and other contribution programs. This work is not part of the internal audit function. It is an integral responsibility of program managers in verifying and controlling contributions.

Scope of the Review

17.58 Our review of departmental internal audit formed part of the government-wide review of Internal Audit reported in Chapter 12. It embraced the administrative and audit procedures of the Internal Audit Directorate including a review of plans and the planning process, audit methodology and programs, operational and financial audit reports and a sample of working papers and correspondence. We did not examine the role of various program planning and evaluation functions performed by others in the Department.

Strengths

17.59 **Mandate.** The Internal Audit Directorate mandate, issued in June 1976 under the authority of the Deputy Minister, provides a wide scope and an important measure of independence. It includes, among other things,

"to provide senior management with an independent objective assessment of:

- (a) the efficiency, economy and effectiveness of operations;
- (b) the compliance of financial and administrative policies and procedures with legislative requirements, the policies and procedures of the Minister and Deputy Minister and those of external agencies; and
- (c) the integrity with which public funds are acquired and expended".

17.60 **Reporting relationships.** The Deputy Minister, to whom the Directorate reports functionally but not administratively, has supported internal audit and this support is perceived by program managers and financial officers. Audit plans are reviewed with the departmental Executive Committee, all audit reports are sent directly to the Deputy Minister and to the responsible Assistant Deputy Minister. The latter is required to respond to any internal audit recommendation with a plan of corrective action within 60 days and a progress report within six months. The Executive Committee recently approved man-year and budget increases for Internal Audit based on an extensive review of the Directorate's needs.

17.61 **Methodology.** The Directorate has developed a useful inventory of procedures, questionnaires, audit programs and skills in preparing well-written, concise and understandable management reports. Nineteen long-form operational or financial audit reports have been issued during the past 30 months.

17.62 **Planning.** A model, recently prepared for developing a long-range plan, improves the definition and planning of audit assignments and provides a basis for ensuring that value for money is obtained from Internal Audit. The Department was analysed on a matrix of auditable units - 13 functional, 88 organizational and seven statutory and benefit; criteria were established to give weight and priority ranking to these auditable units; and a six-year comprehensive plan was developed.

Areas for Improvement

17.63 For each of the areas identified above, further improvements should be encouraged in the continuing development of the function. Of more immediate importance is the need for improvement in the scope of the internal audit activities.

17.64 Staffing. The Financial Management and Control Study recommended in 1976, at a time when there were 14 man-years available to the Directorate, that the internal audit staff "should be increased so that adequate resources are available to carry out an adequate internal audit....". Since that time there has been a doubling of the professional complement, nine of those man-years resulting from the recent in-depth evaluation of the Directorate's capability. At the time of our audit, six authorized positions were vacant. Identification and attraction of well-qualified personnel has been difficult, particularly for EDP-related positions, and the Directorate lacks an experienced EDP audit capability. It has also suffered from high staff turnover.

17.65 *The Internal Audit Directorate should continue its efforts to ensure that:*

- *all authorized man-years are used; and*
- *it acquires appropriate EDP audit capability.*

17.66 Audit of Income Security benefit payments. Past audits of the major Income Security Programs have been limited in number and scope, have emphasized operational efficiency and have relied on the Audit Services Bureau. The long range audit plan calls for three audits a year. Family Allowance, Old Age Security and the Guaranteed Income Supplement will be audited in detail every other year and Canada Pension Plan payments are to be audited every three years. The plan only goes far enough to identify that an audit will be undertaken. It does not give sufficient recognition to the decentralized operational nature of the programs, management's plans to integrate these programs, computer controls and computer audit techniques, the need to review systems amendments to ensure that the auditability of the systems is maintained, and to the need for a continual, annual audit activity in elements of all programs of this magnitude.

17.67 *The Directorate should re-examine and amend its plans for the benefit payment systems audits to:*

- *ensure that the Directorate has a comprehensive understanding of the payment systems before any aspect of the field work is contracted out to Audit Services Bureau or others;*
- *ensure that it has an appropriate involvement in systems amendments; and*
- *detail the nature and extent of the coverage necessary to ensure that key elements of all systems are audited annually.*

17.68 Verification and control of contributions. Field audits to verify contributions to the provinces and others, normally carried out with the assistance of the Audit Services Bureau, are of limited scope, are not based on a review of internal controls, and, because their audits are arranged by program managers, lack independence and objectivity. Internal Audit has not been including in its scope a comprehensive analysis of the policies and procedures in each branch where audits are performed and examinations of the audit practices, working papers and reports of other audit groups.

17.69 The Internal Audit Directorate is not communicating with other legislative auditors, on whose work the Department is relying to ensure that they receive all the departmental information that might be relevant to their audit and that they are aware of the reliance being placed on their work.

17.70 *The Directorate should regularly evaluate all audit activities under the direct control of program officials, including the work of any contracted audit groups involved in the verification and control of contributions.*

17.71 *The Directorate should communicate with legislative auditors whose work is being relied on by the Department.*

17.72 Supervision of field work. The Directorate endeavours to maintain good standards of field work but relies heavily on the personal skills and initiatives of the senior personnel on each assignment. The present audit manual is incomplete and out of date and the procedures for conducting audits, file review and supervision are not carried out in a sufficiently disciplined manner to provide assurance that all areas of operational and financial management are examined, all weaknesses and problems are identified, the significance of observations is recognized and all significant observations are reported.

17.73 *The Internal Audit Directorate should update its manual and procedures emphasizing the need to strengthen and maintain documented evidence of supervision and file review to provide greater assurance that significant areas of audit or audit observations are not omitted.*

Canada Pension Plan Financial Arrangements

General Description

17.74 The Canada Pension Plan was introduced in 1965 as a partially-funded retirement income system to be financed exclusively by employee and employer contributions. It covers nearly all members of the labour force between the ages of 18 and 70 and makes provision for all qualified contributors to receive a pension after retirement or benefits in the event of loss of income due to disability or death. The required contribution is 3.6% of "contributory earnings" and the retirement pension beginning at age 65 is a basic amount equal to 25% of the contributor's average adjusted monthly pensionable earnings. Benefits paid under the Plan are financed from current contributions and the excess of receipts over disbursements is invested in provincial and federal securities. Any enactment to alter the general level of benefits or the rates of contribution requires at least a two-year and one-day period of exposure to Parliament before coming into force and agreement by at least 2/3 of the 10 provinces having in aggregate not less than 2/3 of the population of Canada. The Financial Statements of the Canada Pension Plan are included in Volume II of the Public Accounts.

17.75 The Minister of National Health and Welfare is responsible for administering the Canada Pension Plan with the exception of Part I which rests with the Minister of National Revenue. Part I concerns the coverage of persons and collection of contributions. In addition, the Chief Actuary of the Department of Insurance is responsible for preparing reports on the projected financial state of the Plan and the effects of any proposed amendments. In practice, administrative responsibilities also involve the Departments of Supply and Services, in providing electronic data processing services, and Finance in the financial arrangements governing the Canada Pension Plan Account and the Canada Pension Plan Investment Fund.

Audit Scope

17.76 Audit activities are designed to support the Audit Report provided to the Minister of National Health and Welfare on the financial statements of the Canada Pension Plan Account and the Canada Pension Plan Investment Fund.

Contribution Rates

17.77 Information about the financial status of the Canada Pension Plan, including reference to increased employer and employee contributions needed to ensure that it can meet expected payments and other costs, can be found in notes to the Financial Statements of Canada, Notes to the Financial Statements of the Canada Pension Plan Account and the Canada Pension Plan Investment Fund prepared by the Department, our audit notes of previous years, the actuarial reports to Parliament of the Superintendent of Insurance and the Third Report to the House of Commons of the Standing Committee on Public Accounts. Since this matter was last reviewed by the Standing Committee on Public Accounts:

- the Department has expanded its Notes to the Financial Statements to provide further information concerning the financial status of the Plan; and
- the Chief Actuary of the Department of Insurance is preparing an updated actuarial report, in accordance with a statutory five-year cycle, and is including in that report a computation of the unfunded liability of the Plan. This report will be reviewed by representatives of the Audit Office.

Canada Pension Plan Contributions and Benefits Controls

Background

17.78 The processing of contributions and benefits involves four Departments:

- National Revenue - Taxation collects and records employee contributions and contributory earnings information on computer files that are periodically transferred to National Health and Welfare. The Canada Pension Plan Account is credited with a schedule of estimated daily contributions and is subsequently adjusted to agree to the actual total amounts collected by National Revenue - Taxation.
- National Health and Welfare, through its centralized head-quarters, prepares and verifies benefit applications for computer processing, generates financial information and monitors the status of the principal accounting records and the detailed records of contributions, contributory earnings and benefits. It also maintains local and district offices to serve the public.
- Supply and Services maintains and operates the computer systems and files.
- Employment and Immigration supplies a central index of Social Insurance Numbers that is used for reference purposes throughout the Canada Pension Plan systems.

17.79 The centralized computer systems are large and complex. For example, processing routines involve over 350 computer programs and the Earnings Master File contained 12.4 million records with a cumulative value at year-end of \$5,700 million in employee contributions and \$502,000 million in contributory earnings. Approximately \$1,060 million was paid to 990,000 beneficiaries in 1977-78.

Scope of the Audit

17.80 Audit activities included a review of the controls over the maintenance of computerized systems, programs and files and focused on the documentation, evaluation and verification of the financial and accounting controls over the principal Earnings (Contributions) and Benefits sub-systems. Internal control weaknesses, identified with the aid of systems flowcharts and internal control questionnaires, were reported in detail to management with our recommendations for corrective action. Statistical sampling, computer audit software and manual checks to source documents were used to test the authorization, completeness and accuracy of the accounts and of information in the principal master files.

17.81 No attempt was made as part of this examination to validate the completeness and accuracy of the Social Insurance Number and earnings files received from other departments. Several important sub-systems, such as a sub-system for confirming the continuing status of pensioners, were not examined or tested in detail.

Maintenance of Systems, Computer Programs and Files

17.82 Controls over the maintenance of systems, computer programs and files are not applied adequately. Although the audit tests did not disclose major errors in processing contributions and benefits, many detailed problems were encountered and an unnecessary risk of error, and technical problems could be avoided. Programs that have been amended in the past are not now adequately documented. Policies for controlling amendments are not being adhered to and are incomplete, with the result that amendments are initiated, tested and introduced without formal check or approval by responsible officials in the development and user units. Programmers have access to, and perform maintenance on live files and could possibly lose or manipulate data. Adequate arrangements have not been made for emergency computer processing and offsite storage of backup files. Controls over these systems have traditionally been an operational responsibility with little involvement by financial officers.

17.83 *Controls over implementing and maintaining computer systems and files should be improved to ensure that:*

- *existing computer programs are properly documented;*
- *all systems and program amendments are subject to appropriate authorization and controls by the responsible users, systems analysts, data processing management and financial officers; and*
- *adequate arrangements exist for emergency computer processing and off site storage of backup files.*

Control of Contributory Earnings and Contributions Information

17.84 The magnetic tapes of participants' contributory earnings and contributions information received from National Revenue - Taxation are subjected to computer routines to ensure: (a) the validity of Social Insurance Numbers; and (b) that the number of records and the aggregate amount of contributory earnings and contributions agree with a transmittal letter from National Revenue. Contributions that cannot be matched to a valid Social Insurance Number are transferred to suspense files for manual follow-up where feasible.

17.85 Established control totals of record counts, contributory earnings and contributions on computer files received from National Revenue are not maintained through the various stages of processing. Transaction count control totals were provided for in the original systems design. However, this limited purpose control procedure has not been followed for several years and is no longer possible because proper audit trails were not provided for in system amendments. Amending procedures to correct error and exception transactions identified in the computer routines do not ensure that only appropriately authorized amendments can be introduced. As a result, errors or omissions in recording participants' contributions could pass undetected over a number of years and could cause inaccuracies in determining pension benefits that would be difficult to identify or correct at a later date.

17.86 The detailed computer records of contributions received are not kept in balance with the principal accounting records of such contributions and it is not currently feasible to determine the amount of any difference that may have accumulated. Contribution receipts are recorded daily in the principal accounting records based on predetermined projections prepared by the Department of Finance. In mid-summer of each year, the principal accounting records are adjusted to reflect the actual receipts for the previous calendar year based on personal income tax returns processed by National Revenue-Taxation. The total of actual receipts is not reconciled, or reconcilable, to the magnetic tapes of contributor y earnings and contributions used to update the contributions master files because these tapes contain a blend of multi-year information. Differences between the principal accounting records and the computer files may, and in some cases will, be introduced as a result of weaknesses in the procedures for maintaining systems, updating master files and amending information on the files. Audit trails and control totals are not available to ensure that all adjustments to the computer files are reflected in the principal accounting records. The introduction of appropriate controls will require a major systems design and reprogramming exercise.

17.87 As the Plan matures it will become increasingly difficult to identify, substantiate and correct any errors in contributory earnings information. There is no routine procedure to inform participants of their history of contributory earnings on file on an annual or cyclical basis or on the initiation of benefit payments, and any such procedures introduce major administrative problems. As an interim measure, the Department is initiating a program to inform individuals that they may obtain information on their contributory earnings records by writing the Department.

17.88 It has not been feasible in our audit tests to quantify the significance of the control weaknesses. It is possible that errors in the detailed computer records could be significant in total amount or in the number of participants affected but this is unlikely, based on the experience of the Department in the payment of benefits and in answering queries from the public.

17.89 *A study should be made to examine the benefits and costs of alternative ways of improving the manual and computer controls over contributory earnings records and of identifying and correcting any errors that may be on file. Manual and computer program controls should be introduced to ensure that:*

- *all error corrections will be authorized by persons other than those involved in submitting corrections and after batching or equivalent accounting controls have been established;*
- *independent check and reconciliation procedures are maintained to confirm that the number and dollar value of transactions received from National Revenue - Taxation will be accounted for after the final update of the earnings and contributions master file, and the detailed contribution records will be in agreement with the monies received and the principal accounting records;*

- *reconciliations and key control conditions will be checked by independent staff and reviewed and approved by supervisors; and*
- *policies, procedures and controls will be comprehensively documented and communicated to the staff involved and applied in practice.*

Control of Benefit Payments

17.90 There are adequate financial and accounting controls over the processing of benefit payments, subject to relatively minor weaknesses in the manual controls over input documents and the limited scope of our audit this year. Improperly authorized benefit application and change orders could be introduced to the system and authorized transactions could be lost because accounting controls are only established by a batch control unit after input documents have passed through the principal verification, checking and approval processes, and because processed batches are returned to the same unit before being returned to the originating department. Controls are maintained to confirm that all benefit transactions are accounted for through to the final update of the benefits master files and the principal accounting records, but these important controls are not subject to supervisory review to ensure there is no lapse in their maintenance and that all exceptions have been appropriately dealt with.

17.91 Detailed audit tests revealed only a few minor discrepancies of little significance. These tests used computer audit programs to check the accuracy of benefit files, recalculate pension entitlements, compare some key relationships on the eligibility and status of pensioners, and select records for checking against source documentation.

17.92 *Accounting or batch controls over benefit applications and change orders should be established before authorization of these input documents and the important reconciliations of input control totals to updated master files and the principal accounting records should be subject to independent check and supervisory approval.*

Family Allowance and Old Age Security-Benefit Controls

Program Description

17.93 Benefits and entitlements under this program, amounting in total to approximately \$7,000 million in 1977-78, are summarized as follows:

- Old Age Security is a basic monthly pension payable at age 65 to persons who have met certain residence requirements. The basic rate is adjusted for those who have not met the full residency requirement;
- Guaranteed Income Supplements may be added to the basic Old Age Security benefits where income in the preceding year, computed in accordance with the Income Tax Act and combined for a married couple, is below scheduled levels;
- Spouse's Allowance may be paid to the spouse of an Old Age Security recipient if the spouse is between ages 60 and 65 and their combined income is below scheduled levels; and

- Family Allowances are paid in respect of children under the age of 18 who are resident in Canada and maintained by parents or guardians, one of whom must also meet residency and citizenship requirements.

17.94 The program is administered through a headquarters staff in the National Capital Region and regional offices in provincial centres. The Department of Supply and Services designed and operates the computer systems but each region is responsible for the administration of the program, for the receipt, verification and control of applications and the payment of benefits.

Scope of the Audit

17.95 The audit extended the general evaluation of computer controls in one regional office as reported by the CAISE Study in paragraph 6.18 of the 1977 Report. It went more specifically into the documentation and testing of manual and computer controls and sample transactions in the Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia Regions. Extensive use was made of systems flowcharts, control evaluation questionnaires, computer audit programs and statistically based samples.

Strengths

17.96 The findings of the CAISE Study indicated that in general these systems have adequate financial and accounting controls subject to the need to rely on timely and accurate data prepared by non-departmental sources and some minor elements of financial control that have not been implemented.

Areas for Improvement

17.97 More extensive audit examinations have identified additional relatively minor weaknesses in the manual controls over input documents, controls over reconciliations and exception reports, and information maintained on computer files. Detailed weaknesses and recommendations, which are not consistent among regions, have been discussed with headquarters and each of the regional managers. The absence of these controls may provide an opportunity for error but do not necessarily mean that errors have occurred. Our audit tests did not disclose any significant errors.

17.98 Controls over input documents. In the sequence of processing benefit applications and other input documents, document and accounting controls are not established early enough in the system to ensure that improperly verified and authorized transactions cannot be introduced to the system and that all authorized transactions are processed without subsequent delay, error, alteration, omission or duplication. Compensating controls or post-audit error detection procedures to identify and monitor the significance of weaknesses have not been introduced in all Regions.

17.99 *Document and accounting controls should be established before the key steps in the verification and authorization process and, where this is not economic or feasible, post-audit programs to monitor the significance of the weaknesses should be improved.*

17.100 Controls over reconciliations and exception reports. Headquarters and the regions have many important reconciliation and computer routines designed to identify improper information or errors. These would include incomplete or invalid input identified during processing as well as mismatches of files with other departments, provincial birth and death registers, files of prior years and manual

records. Some of these routines, and the procedures for following up exceptions, could be made more reliable with improved procedural documentation, training and properly evidenced supervisory controls.

17.101 Controls over reconciliations and follow-up procedures on exception reports should be made more reliable through improved procedural documentation, training and supervisory review.

17.102 Maintenance of data on file. The systems involve large computer files that are subject to continuous amendment and contain data that remain on files for long periods of time. As noted above, the exception reports that are produced are not under adequate supervisory controls to ensure that appropriate corrective action is taken in every instance. These factors increase the risk that data could be lost, manipulated or retained on file accidentally or intentionally. There are no specific procedures to ensure that the standing data on file are properly maintained.

17.103 Procedures should be developed to confirm that control over standing data on computer files is being properly maintained, including measures such as:

- *systematically test-checking selected records of beneficiaries to source information; and*
- *periodically scanning the master benefit files for unusual items.*

Family Allowance and Old Age Security - Performance Measurement

Background

17.104 The Income Security Programs Branch administers the Old Age Security, Guaranteed Income Supplement, Spouse's Allowance and Family Allowance programs through a network of 10 regional offices involving approximately 2,000 employees. An established performance measurement system is designed to monitor relative productivity among regional offices.

Scope of the Pilot Study

17.105 The initial review of the performance measurement system was an exploratory pilot project, as part of the government-wide Study of Procedures in Cost Effectiveness, designed to help develop value-for-money auditing procedures for application in other government departments in which performance measurement plays, or should play, a role in the control of efficiency. We did not attempt to examine the way in which performance information was being used to control or improve efficiency, other aspects of efficiency, or the evaluation of program effectiveness. We visited the British Columbia, Ontario and Atlantic Regional Offices and National Headquarters. This Study helped develop an initial set of guidelines and performance measurement criteria for the staff investigating some 16 program areas in 12 other departments.

17.106 Our criteria related to the following systems issues:

- the adequacy of the systems technology;
- the adequacy of standards or bases for comparison;

- the usefulness of performance information as an efficiency control and improvement device; and
- the reliability of the information.

General Evaluation

17.107 Our review of the performance measurement system revealed only minor control weaknesses. We found evidence of management support for the system and use of performance information in monitoring the efficiency of operations. Management was also active in maintaining the system's relevance and validity in the face of legislative and operational changes. In the last 18 months they have modified it to improve further the validity and format of the information reported.

Findings of the Pilot Study

17.108 The Study found ample evidence to indicate that performance information is being used in (a) the allocation of resources in the Branch; and (b) the monthly monitoring of resource use and performance in relation to plans.

17.109 However, the Study concluded that the output measurement in the efficiency calculations for the major program areas was over-simplified and this over-simplification restricted the system's usefulness in monitoring short-term efficiency fluctuations. The Study suggested that the Branch consider using output measures more closely related to the activities carried out in administering the program and to specific transactions.

Subsequent Improvements

17.110 During the Pilot Study, the Management Services group in the Branch conducted a survey of the performance measurement system using management questionnaires to identify user needs, a key feature of any successful system.

17.111 Improvements introduced in 1977 to enhance the usefulness of the systems to operational managers can be summarized as follows:

- development of a common operating structure in all 10 Regions;
- redefinition of outputs;
- corresponding redefinition of input allocation;
- introduction of new effectiveness indicators;
- modifications to existing effectiveness indicators;
- improvements to existing operational forms, management reports and procedures manuals;
- revamping and streamlining of national management report; and

- introduction of additional management reports, including a monthly narrative analysis report to operations management and a quarterly senior management summary.

17.112 The most significant improvement in the system was the revision of the measurable units of output. It was recognized that transactions provide a better indicator of workload than active accounts but they introduce more difficult problems of data accuracy and control. Management considered transactions but selected "weighted account types", as a practical alternative that improves on previous measures.

Program Description

17.113 The Canada Assistance Plan, financially the most significant Social Assistance program, provides federal funding to the provinces of 50% of the cost to the provinces and municipalities of "assistance" to people in need and of "welfare services" to people who are in need or likely to become so if they do not receive help. The total costs in 1977-78 amounted to approximately \$1,600 million. These programs are established, administered and controlled by the provinces and cover a wide range of assistance and welfare services, work activity projects and costs relating to the administration of these programs.

17.114 All provinces participate under the provisions of the Canada Assistance Plan. Contributions to provinces other than Quebec are paid in cash and those for Quebec are paid in tax points and a cash supplement by special arrangements under the authority of the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, 1976-77, c. 10.

17.115 Assistance includes payments, at rates determined by the provinces, to persons in need of basic requirements such as food, shelter, clothing, fuel; items of special needs, such as essential repairs to property; and care in welfare institutions, such as homes for the aged, nursing homes and child care institutions.

17.116 Welfare services sharable under the Plan include rehabilitation services, casework, counselling, assessment and referral services for individuals and families; and child care services including protection, day care, adoption services and preventive services to children in their own homes.

17.117 The Canada Assistance Plan is one of the largest and has been one of the most rapidly expanding programs of government. It is a complex and difficult program to control and monitor and the success of the program as well as the effectiveness of any financial controls depends on the co-operation of the provincial and municipal governments.

17.118 Many of the most administratively complex welfare services and some of the assistance components of the Canada Assistance Plan have been, or are being, transferred out of the program and replaced by alternative arrangements for funding provincial programs. Effective April 1, 1977, certain extended health care services and assistance, equivalent to an estimated \$333 million in costs for 1977-78, were transferred out of the Plan to the Health Care Program. Since April 1, 1978, all the remaining welfare services and some assistance, equivalent to an estimated \$512 million in costs for 1977-78, may be transferred out of the Plan and replaced by new social services financing arrangements agreed to by the provinces in March 1978 and reflected in a proposed Social Services Financing Act, Bill C-55, tabled in the House of Commons in May 1978.

Scope of the Audit

17.119 The audit examination included a review and evaluation of the financial and administrative controls over contributions to the provinces and territories based on detailed examinations conducted in Ontario and Saskatchewan and some limited tests in the other provinces. It included a review of the control exercised by departmental representatives in provincial capitals, the arrangements with the Audit Services Bureau, departmental communications with the legislative auditors of the provinces and the systems for assembling cost and related information received from provinces. We also tested the approval and accuracy of selected payments and analysed certain outstanding balances with the provinces.

Strengths

17.120 Experienced staff. Program eligibility and shareability is determined primarily by Headquarters staff with the help and advice of departmental Field Representatives in provincial capitals. Routine application of these decisions, including the eligibility of clients, is determined and monitored primarily by Field Representatives with the help and advice of Headquarters. Interpretations and precedents in determining eligibility and shareability are the subject of extensive ad hoc correspondence and discussion between provincial officials, Field Representatives and Headquarters because the range, nature and cost components of assistance and welfare services programs vary among provinces.

17.121 The work of Field Representatives requires judgment and an in-depth knowledge of the provincial programs and previous eligibility interpretations supported by centrally monitored listings of allowances and welfare services approved for each province, liaison with provincial government officials, liaison with Headquarters and inspections of facilities. Administration of this program requires, and has benefited from, continuity of staff. The Director General of the program, the senior staff at Headquarters and the Field Representatives are experienced program officers, most of whom have been involved in administering some aspect of the program at the federal or provincial level for many years, if not since its inception.

17.122 Verification of contributions. By statute and government-wide policies, claims submitted by the provinces and the supporting provincial records are subject to federal examination and verification to the satisfaction of federal officials. In practice, departmental Field Representatives are personally required, through their discussions and field visits, to satisfy themselves as to the eligibility of the provincial welfare, assistance and administrative activities and to provide a signature as to evidence of this responsibility. The Audit Services Bureau is contracted to assess the accuracy of cost information after each claim has been certified by the provincial legislative auditor. Audit Services Bureau has been checking claims to provincial accounting records, in some cases has been conducting more detailed audit tests, and has been preparing extensive reports, identifying questionable items or accounting errors for the periods under review. These reports are submitted to program officers for clearance and settlement with provincial officials. Normally this is a three-year process - a year for the provinces to submit their claims, a year for federal audit and a year to reach a final settlement. Some settlements or recoveries of overpayment may involve lengthy discussions and frequently require five or more years.

Areas for improvement

17.123 Impact of legislative changes on program administration. The transfer of many of the most administratively complex welfare services from the Canada Assistance Plan should, in the long term, greatly reduce the problems of administration and control, but in the short term, presents a significant and time-consuming administrative problem.

17.124 The accounting records of the Canada Assistance Plan and many of the provincial departments and agencies submitting claims under the Canada Assistance Plan do not maintain an accurate segregation of costs between welfare services and assistance components that have been, or are to be, transferred out of the plan and those that remain eligible. This necessitates a retroactive analysis of costs and program eligibility, at all levels of participation. In the case of the proposed new Social Services Financing Act, funding arrangements are to be based on 1977-78 costs under the Canada Assistance Plan as a base year, adjusted by population, indexing and levelling formulas plus additional funds to cover new services. There may be significant difficulties in establishing and obtaining agreement on the 1977-78 base year costs. Program officials expect that the process may take several years.

17.125 Program officials have a plan to cope with this expected new administrative challenge that provides for a gradual increase in staff resources to supplement the existing complement of about 90 persons involved in administration of the Plan. The complexity of the program, the need for experienced and knowledgeable staff and the dependence on other participants at the provincial and municipal level, make it difficult to introduce new staff resources or more comprehensive plans suddenly to minimize expected administrative problems. Significant staff additions will need to be phased in and supported with appropriate on-the-job training.

17.126 The plans and progress of program officials in giving effect to legislative changes should be independently reviewed and periodically monitored to ensure that all practicable action is being taken to expedite and maintain control over the establishment of cost information required.

17.127 Documentation, communication and application of the present financial policies, responsibilities and procedures. Administrative and financial controls differ within the Canada Assistance Plan depending on the structure of the provincial welfare services and assistance programs and the role of different participants.

17.128 The scope of the activities of Field Representatives is not planned or approved centrally and has not been subject to effective review or internal audit. They are expected to visit and make recommendations to Headquarters on the eligibility of new facilities and persons in them, and to review provincial accounting records, but this is done without the benefit of a comprehensive work program containing recommended procedures, inspection programs or standards of acceptability, field work or cyclical confirmation. The Audit Services Bureau is engaged to assess the accuracy of costs, one or two years later, within a mandate that explicitly excludes consideration of eligibility and without appropriate direction or supervision by the Department. The role and relationships of Field Representatives and Audit Services Bureau are not consistent among regions. Neither group has been giving appropriate consideration to a systems based audit approach, the potential role of other auditors and, subject to appropriate communications and discussion, the degree of reliance that can be placed on prior levels of audit. Where potential adjustments are identified in the audit, these are reported to program Headquarters and Field Representatives for negotiation and settlement. There is no independent process to make visible and review the effectiveness of program management in resolving unsettled amounts and recovering overpayments.

17.129 The problems of identifying and assembling financial and performance information for preparing budgets, maintaining accounts and monitoring costs, program content and performance have been addressed by the Department although it still relies generally on ad hoc requests by Field Representatives for information from the various provincial departments. Responses vary in form, timeliness and accuracy and in many cases have been supplemented by input from Field Representatives and Headquarters staff. Claims submitted by the provinces normally include detailed

costs by type of service or assistance, but because of inconsistencies this detailed information is captured in the principal accounting records in only seven major cost categories. For example, the federal share of the cost of children's day care services can not be separately identified in the accounts. An abundance of output information is supplied to the Department, but it is received in differing forms and degree of detail from each source and is used only indirectly in preparing budgets and monitoring costs. As a result, financial projections and the information included in the Estimates have lacked certainty and precision, and the accounts do not provide a particularly relevant basis for monitoring costs or changes in program content.

17.130 Many of our detailed audit observations and concerns reported to management tended to focus on the desirability of more comprehensive systems for clarifying, documenting and communicating financial policies, responsibilities and procedures to all federal and provincial participants in the program. It would be desirable to have a comprehensive system for communicating guidelines, preferred practices and interpretations, developed in conjunction with other participants as appropriate, dealing with such subjects as the role of participants, audit, eligibility of programs and costs, the need for financial and statistical information for monitoring the program, budget preparation, claim processing and final settlement procedures.

17.131 Program officials acknowledge the desirability of clarifying and improving their documentation and communication of financial policies, responsibilities and procedures both within the Department and for the assistance of other participants. However, at the present time they do not believe it is feasible or practical given the impact of legislative changes on the program. The remaining public assistance component of the Plan should lend itself to a more explicit system of control in the future.

17.132 Although it is difficult to establish that the controls to ensure consistent and reliable determination of the eligibility and shareability of costs claimed by the provinces are reliable, our audit observations did not include any evidence that significant unidentified overpayments are occurring.

17.133 *Subject to the need to obtain and allocate experienced staff resources, management should initiate a program to:*

- *develop comprehensive systems documentation relative to the public assistance program that will continue under the Canada Assistance Plan;*
- *provide more active direction and supervision to the contract audits performed on behalf of program management;*
- *ensure that the work of Field Representatives and contract auditors are reviewed by Departmental Internal Audit; and*
- *ensure that there is an effective, independent monitoring process to confirm that program management continues to take all possible effective action to ensure program and client eligibility, resolve unsettled accounts and recover overpayments.*

Health Care

Program Description

17.134 The major expenditures of Health Care come under agreements with the provinces that were fundamentally restructured effective April 1, 1977.

17.135 Until March 31, 1977, the Department reimbursed the provinces, in accordance with population and cost weighted formula, for approximately 50% of the actual costs of provincial services eligible under the Hospital Insurance and Diagnostics Services Act, R.S., c. H-8 and the Medical Care Act, R.S., c. M-8. Provincial cost claims, certified by provincial legislative auditors, are subject to review by the Department and in the case of Hospital Insurance, field audits by the Audit Services Bureau as its representative. Questions as to the interpretation of the eligibility of costs or services that arise during these reviews have to be negotiated with the provinces and, as a result, final settlement of many claims may require several years. As at March 31, 1978, all claims for Hospital Insurance to December 31, 1974, and Medical Care to March 31, 1977 have been through the detailed verification processes, although there are items from 1973 to 1977 that remain subject to final negotiation and settlement.

17.136 Effective April 1, 1977, and for a minimum of five years, the Health Care contributions, and the Post-Secondary Education Payments of the Department of the Secretary of State of Canada have been designated as Established Programs under Part VI of the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977.

17.137 Under the new act, federal contributions to the provinces are no longer tied to provincial costs. Transfers to the provinces are a blend of cash and a reduction of federal income taxes to enable provinces to impose their own tax measures without a net increase in taxation. Cash contributions are determined by the national average per capita contributions in 1975-76, provincial populations, and escalation, levelling and transitional adjustments. Payments are conditional in that provincial plans must continue to meet the respective program criteria of the Hospital Insurance and Diagnostic Services Act and the Medical Care Act. The Act also subsumed certain Extended Health Care Services that previously had qualified for federal funding only when provided to persons in need as defined in the Canada Assistance Plan and, in this respect, payments are conditional on complying with certain informational requirements. Subject to the program conditions, the Department of National Health and Welfare contribute to the provinces in accordance with schedules received from the Department of Finance, which calculates the amounts of payments and maintains computerized records for this purpose. All payments are provisional and subject to subsequent adjustments reflecting any changes to the 1975-76 contributions base as a result of negotiations and settlements of claims under the shared-cost arrangements in effect at March 31, 1977.

Scope of the Audit

17.138 For shared-cost claims up to March 31, 1977, our audit took place at Headquarters and in provincial capitals and included reviews of the audit and verification activities of departmental officers and the Audit Services Bureau, examination of selected provincial claims, supporting correspondence and audit reports, discussions with provincial officials in some cases, and the monitoring of action taken or progress in the negotiation and final settlement of questionable costs.

17.139 The audit examination of contributions in 1977-78 included a review and selected tests of the application of the payment formulas provided for in the legislation and of payment records maintained by the Departments of Finance and National Health and Welfare.

Settlement of Shared Costs to March 31, 1977

17.140 Contributions for shared costs paid to the provinces under the arrangements to March 31, 1977, are still subject to verification, negotiation and final adjustments where the eligibility of costs or services is not clear. Further contributions may ultimately be required for provincial claims not yet submitted or processed and for items under negotiation. Normally, the verification processes of the Department and

Audit Services Bureau, and in some instances our audit examinations, lead to many relatively minor adjustments which are subject to negotiated settlements with provincial officials. More substantial adjustments could result from discussions now under way with specific provinces as to the eligibility of certain services and the use of alternative population records as provided for in the legislation then in effect. The outcome of these discussions will affect the 1975-76 base for the five-year term of the current financial arrangements.

17.141 The conditional contributions provided for in the current act will not give rise to future problems of this type. We will continue to monitor the adequacy of controls relative to the shared costs under the arrangements to March 31, 1977, until all claims have been settled.

Accounting for Payments Since April 1, 1977

17.142 The present method of allocating payments to Hospital Insurance and Medical Care in the Estimates and Public Accounts does not provide any useful cost information. It is likely to make it more difficult for users of these documents to understand and analyse the current financial and administrative arrangements and the significant changes effective April 1, 1977. Payments are no longer directly related to costs of the programs and legislation with which they are being identified. The Department of National Health and Welfare is making payments on the basis of data provided by the Department of Finance. The total cash contributions to the provinces under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, are being allocated to Hospital Insurance, Medical Care and Post-Secondary Education Programs based on the relative costs of these programs in the 1975-76 fiscal year. The formula for determining these cash contributions was developed as part of a complex fiscal arrangement involving a substantial transfer of income tax points to the provinces.

17.143 Payments made under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, and allocated to the Health Care and Post-Secondary Education Programs, should be supported in the Estimates and Public Accounts by a comprehensive schedule providing cash and non-cash costs and comparative information reflecting payments under the previous fiscal arrangements for Hospital Insurance, Medical Care, Extended Health Care Services and Post-Secondary Education.

Medical Services

Program Description

17.144 The most significant component of this Program is providing eligible Indians and all residents of the Territories with a standard of health care comparable to that of other Canadians. This includes the direct administration of 14 hospitals and approximately 430 remote treatment centres through 9 regional offices located in major cities across Canada and 31 zones. It also includes the financing of provincial health insurance premiums for indigent Indians, preventive health programs, patient travel, dental treatment, prescription drugs, eyeglasses and services provided by private practitioners. In 1977-78 these activities accounted for approximately \$117 million out of \$140 million in expenditures and absorbed 3,080 of the 3,966 available man-years. Other components of this Program include Civil Aviation Medicine, Public Service Health, Immigration Medical Services, Quarantine and Regulatory Services, Prosthetic Services and Emergency Health and Welfare Services.

17.145 The objectives and nature of the operations of the Indian and Northern Health Services highlight the need for comprehensive financial and performance information to assist in the allocation and management of resources. There is no specific legislation establishing the means of providing services, the nature of the services, or criteria for patient eligibility, and program-wide policies to this effect were only established in August 1978. "A standard of health care comparable to that of other Canadians" is not readily identifiable or measurable and there is unlimited potential for service. Important variables include the level and scope of treatment services, the determination of indigency and Indian status, the emphasis to be given to preventive programs, the transportation of patients and medical staff versus the construction of remote facilities, and direct treatment versus the subsidization of local services or use of provincial facilities. Regional offices operate with considerable autonomy, have been delegated spending and payment authority and the authority to reallocate resources within the region. In addition, activities of the Department of Indian Affairs and Northern Development have considerable impact on the objectives of the Medical Services Program.

Scope of the Audit

17.146 Our 1976-77 audit activities included a review of financial controls in the Alberta, Northwest Territories, Saskatchewan and Manitoba Regional Offices; the Charles Camsell and Norway House Hospitals; and the Prosthetic and Emergency Health Services activities. Over 100 observations and recommendations were made to Regional Offices and Branch Headquarters dealing with a broad range of detailed issues relating to the adequacy of the checks and balances over items such as payrolls, delegation of authorities, determination of indigency and patient eligibility, patient travel, inventories and capital assets, prescription drugs, revenue and accounts receivable records, the need for a financial manual, and staffing of the financial function. Within 90 days the Branch provided action plans in response to these observations.

17.147 Our 1977-78 audit activities focused on the availability and use of financial and performance information, the processes of budget preparation and financial reporting and the role of the financial function in the Indian and Northern Health Services. It included field audits in British Columbia, Alberta and Ontario Regions and the Charles Camsell and Moose Factory Hospitals.

Strengths

17.148 The senior officers at Headquarters and in the Regions are generally experienced medical officers who have good knowledge of local operations and are actively involved in them. Their accounting and financial reporting needs are met with the use of the central financial reporting services of the Department of Supply and Services based on payment, commitment and accrual transactions input to the latter's Regional Services Offices. From the computer-prepared reports, regional managers provide Headquarters with explanations by object of expenditure, of differences between actual and budgeted results.

17.149 Effective April 1, 1978, and subsequent to our detailed audit field work, a comprehensive performance measurement system was introduced using departmental computer facilities. This system is designed to assemble performance statistics on the patients treated and the types of treatment for each treatment centre.

Areas for Improvement

17.150 Availability and use of financial and performance information. At the time of our audit regional and Headquarters management did not, receive necessary comprehensive financial and performance information, supported by useful analysis, to facilitate effective allocation of resources and monitoring of costs and performance. Cost information is being developed for responsibility centres in terms of objects of expenditure, but not in terms of a profile of patients treated and the type of treatment or service provided. Performance information on the services provided is not co-ordinated with cost information to facilitate cost comparisons, analysis and operations review. Financial reporting requirements were not identified and developed in conjunction with the development of the performance measurement system.

17.151 There are plans to amend the activity structure for the 1980-81 fiscal year to reflect the new performance measurement system and to consider alternative financial reporting systems to better meet the information needs of managers. To facilitate monitoring of costs and performance, responsibility centre managers should be provided with an integrated analysis of financial and performance measurement information.

17.152 The budget preparation process. The preparation of Program Forecasts at Headquarters is balanced with general financial forecasts performed at the zone and regional level to aid in allocating resources within the program. Additions to the program are justified by exception without detailed analysis of continuing costs. Headquarters and the Treasury Board Secretariat review the Program Forecast, establish an expenditure ceiling and communicate it to regional managers. Regions are expected to prepare detailed operating budgets that remain within the imposed ceilings.

17.153 Some regions, hospitals and zones have individually tailored systems for preparing operating budgets, but Headquarters has not provided coordinated direction for these systems, introduced guidelines on cost and service priorities, or had the time to review or challenge the regional operational budgets. Audit observations included the allocation of a general Program Forecast decrease to categories of subsidized service that are considered to be outside management's control, failure to analyse and bring attention to the financial implications of several acknowledged problem areas, such as the need to define eligibility for treatment and subsidized service and the development of a capital budget without a corresponding provision for the costs of staffing and operating the proposed facility.

17.154 Subsequent to our audit, guidelines as to the eligibility of patients for subsidies and service have been prepared and distributed to all regions.

17.155 *The budget preparation process should be strengthened by:*

- *improving the central directions to be followed in preparing operational budgets, standards of financial analysis and information to accompany budget submissions, policies and guidelines on program matters, such as the nature and level of services to be provided; and*
- *ensuring that the Branch Financial Adviser is responsible for performing a detailed review and challenge of budget documentation to establish the reliability of the information as a reflection of operating plans and as a basis for establishing accountability and monitoring performance.*

Revenues for Hospital Care

17.156 Hospital revenues for patients treated are below the costs of these services. In 1977-78 the hospitals incurred expenditures of \$29 million and recovered revenues of \$20 million as reported in Volume II of the Public Accounts of Canada. Revenues are based on per diem and treatment rate schedules determined by regional managers and provincial officials and vary for each hospital and service. Inequities in the rate schedules have been the subject of concern and discussion. In some cases provincial officials consider per diem costs excessive or supporting accounting records inadequate. Excessive costs are generally attributable to the costs of operating in remote locations, under use of facilities and the need for extended recovery periods for many patients. Discussions are also influenced by proposals to transfer some facilities to provincial or municipal governments and by recognition that, before March 31, 1977, the Health Care Program of the Department funded 50% of provincial hospital plans.

17.157 *Revenues for hospital care recovered from provincial hospital insurance plans should be under continuous review and analysis by the Branch Financial Officer to ensure that:*

- *Regional Management involved in negotiating per diem and service rates is provided with complete and accurate cost information; and*
- *possible inequities or anomalies in per diem and service rates are brought to the attention of senior branch or departmental officials.*

Fitness and Amateur Sport

Program Description

17.158 Activities for the promotion and improvement of fitness, physical recreation and amateur sport included contributions towards more than 1,800 projects by some 400 groups, associations and individuals. In 1977-78 contributions of \$21 million were financed under Fitness and Amateur Sport and \$4 million were financed by the Treasury Board from revenues received from Loto Canada.

17.159 The Department has experienced difficulty in clarifying the program's role in response to changing emphasis in national policies and a rapidly expanding scope, level of service and financial support provided in recent years to fitness and amateur sport activities. These difficulties have contributed to the acknowledged weaknesses in the systems of financial management and control identified by internal audits, by this Office and by departmental management. The very real desire of Branch management to improve its program and financial management is reflected in various studies and proposals such as the Green Paper on a National Policy for Amateur Sport, an in-depth study of the contribution system by the Bureau of Management Consulting, and proposals to improve the Branch's budget structure and information systems.

Scope of the Audit

17.160 Audit activities included an evaluation of the systems of financial management and control with emphasis directed toward the budgeting, approval and control of contributions, detailed examination of selected contribution records and a limited review of administrative costs.

Leadership and Staffing of the Financial Function

17.161 The Branch has underestimated its requirements for leadership, direction and staff in the financial function. The senior full-time financial officer is not a member of the management committee and reports to a Director of Administration and Program Services who has other major and competing administrative and program responsibilities. New appointees to senior positions have in the past year made intensive efforts to improve the standards of financial management and control but much remains to be done to ensure that planned systems improvements result in effective financial direction, advice and control within the Branch and, to provide leadership and guidance where it is needed in some of the sport and recreation associations and the quasi-independent corporations.

17.162 The role of the Branch's financial function should be closely monitored to ensure that planned systems improvements are effectively implemented and that the function will receive the necessary leadership and staff support in the future.

Verification of Contributions

17.163 During the last year the Branch completed an extensive analysis of its accounts with recipients of contributions to identify, review and make decisions in cases where recipients had failed to comply with the terms and conditions of the contributions. The Branch had been reluctant to insist on written acknowledgement of the published terms and conditions of contributions and by March 1977 had fallen far behind in its desk and field audits to verify contributions. The review required a major involvement of senior management and financial officers, supplemented with contract staff, over a period of several months. Many recipients had not been adhering to requirements to maintain proper accounts and records, to submit an accounting for the contribution within 90 days, to refund any unspent funds, and to provide progress reports on projects. Repayment schedules had to be negotiated with over 100 organizations and in some cases subsequent requests for funding were refused based on past deficiencies in meeting the terms and conditions of contributions.

17.164 The status of the verification of contributions has improved substantially in the last year. The backlog of over 1,400 desk audits has been virtually eliminated and a weekly report of overdue accounting reports and follow-up procedures by program officers has reduced the number of delinquent accounts.

17.165 The Branch has not yet adopted a policy of requiring written acknowledgement from recipients of terms and conditions, and does not have established audit plans, work programs and reporting procedures to ensure that audits are performed in accordance with prescribed schedules and standards.

17.166 The procedures for performing and monitoring the verification of contributions should be based on:

- formal agreements with recipients specifying the terms and conditions of the contributions;*
- formal plans and audit programs to ensure consistent and objective standards of audit; and*
- formal reporting procedures and supervisory controls to ensure that audit activities remain timely, any required corrective follows action is taken, and the results of the audit activity are communicated to Branch officials.*

Documentation of Financial Policies, Responsibilities and Procedures

17.167 The existing financial policies, responsibilities and procedures for internal use throughout the Branch and for communications with recipients of contributions, have not been comprehensively documented and distributed.

17.168 *Financial policies, responsibilities and procedures should be comprehensively documented and communicated in manuals for use within the Branch and by recipients of contributions.*

Budgeting, Project Approval and Management Information

17.169 Implementation of desirable improvements to the budgeting, project approval and management information systems will require comprehensive planning and strong central leadership. The existing systems, developed within standard government-wide systems for assembling financial information, do little to facilitate the effective allocation of resources and financial planning, either by the Branch or by recipients of contributions, and do not provide clear budgetary responsibility for program managers and officers dealing with recipients. The current program and activity classification is not considered consistent with current objectives, and proposals to update the activity structure have not been approved by the Treasury Board Secretariat. Objectives as stated in the Estimates have not been supported with more explicit operational objectives or goals that could be used for guidance in allocating resources and monitoring performance. The main organizational components, including Fitness and Recreation Canada and Sport Canada, have shared objectives, and both the current and proposed activity classifications are inconsistent with organizational responsibility. Some of the organizations receiving contributions may also have objectives that cross the organizational lines of the Branch. Although all contributions are awarded for specific projects approved by the Minister, these projects are not always identified or identifiable at the time of budget preparation, the principal accounting records are not maintained by project, and the comparative year-to-year total funding to each sport or association remains a significant factor in the approval process. In addition, the extent of funding available through Loto Canada revenues can only be determined towards the fiscal year-end. All of these factors complicate the budget preparation, approval and monitoring processes and result in considerable uncertainty and internal competition for project approvals during the year.

17.170 The Branch has established a separate computerized system to monitor the status of projects and cash requirements and is in the initial stages of implementing recommendations of the Bureau of Management Consulting to improve the control of transactions and project approvals. These improvements will strengthen controls and improve the financial information available to management on approved projects. Further improvements will be required to minimize inherent uncertainties in the budgeting and approval processes and provide an integrated system for monitoring performance.

17.171 The current systems and proposals are designed to control contributions on a project-by-project basis. In-depth consideration has not been given to alternative, potentially less cumbersome ways of providing financial support to those organizations that may be able to demonstrate that reliance can be placed on their systems of planning, financial management, financial reporting and audit.

17.172 *Further improvements to the budgeting, project approval and management information systems should ensure that:*

- *activity classifications, project accounting records and organization structures are effectively integrated so the financial responsibility and authority of program officers can be established and monitored;*

- *budgets are comprehensive and as clear a reflection of objectives, operating plans, resource allocation decisions and criteria for measuring performance as is feasible at the time of their preparation;*
- *the senior financial officer will be in a position to provide the Assistant Deputy Minister with more complete and reliable advice and information on all financial matters; and*
- *appropriate consideration is given to potentially more efficient ways of directing financial support than the existing project-based contributions, to recipients with good planning and financial management systems.*

Payroll

Background

17.173 The Department employs approximately 10,500 continuing and term employees and in 1977-78 incurred payroll costs of approximately \$161 million. Pay Administration is decentralized to four National Capital Region pay offices, an Atlantic regional office and, for casual and term employees, to other regional offices of the major programs. The Director General - Personnel Administration and the Personnel Administration Directorate provide central guidance. The Department of Supply and Services processes the payroll, returning cheques to departmental financial officers for distribution.

17.174 In accordance with Treasury Board Circular 1977-37, the Department has rewritten its Pay and Benefits Manual and conducted introductory seminars in preparation for a new concept of pay administration that stresses Departmental rather than the Department of Supply and Services responsibilities for control over source documents, payroll processing and payroll distribution. Some of these concepts are being progressively implemented pending the approval and formal introduction of changes in the central systems of the Department of Supply and Services.

Scope of the Audit

17.175 The audit included an evaluation of control over the processing of source documents used to initiate pay and pay adjustments for salaried and casual employees handled by the four headquarters pay offices and the Ontario regional offices of the Income Security, Canada Pension Plan, Medical Services and Health Protection programs. A sample of over 400 pay transactions were selected from these locations and checked to authorities, manual records and source documents. The audit included a review of the controls over the accounting for payroll costs within the Department, but did not specifically review the controls over the processing of payrolls maintained with the Department of Supply and Services.

Responsibilities for Pay Administration

17.176 Responsibilities for financial control in pay administration have not been appropriately and clearly defined, communicated and acknowledged and there has been a lack of functional direction. The responsibility and authority of the Personnel Administration Directorate over the decentralized pay offices is not clear and the Directorate lacks the staff resources or systems to provide strong central direction, training or supervision in the design and operation of decentralized payroll systems. Their Pay and Benefits Manual establishes basic pay procedures without specific guidance as to the responsibilities of key participants in the system or reference to financial controls for effectively

implementing these procedures. The designated "Senior Departmental Pay Administrator" is two levels below the Director General - Personnel Administration.

17.177 The Financial Administration Directorate, which has had a functional responsibility for the financial controls in payroll systems since our Financial Management and Control Study in 1976, has not yet had significant participation in the review or design of these systems. The Directorate has had extensive involvement in the departmental introduction of revised pay distribution procedures and has co-operated with the Personnel Administration Directorate in preparing a departmental response to Treasury Board Circular 1977-37 on pay administration. Branch Personnel Advisers serving each of the major programs have been left to their own devices to develop or improve their detailed systems of control with the result that there are many weaknesses and inconsistencies in the procedures at the various pay centres. The Personnel Management Manual and Financial Administration Manuals are not complete or up-to-date and pay and benefit clerks depend on their acquired experience to perform their duties.

17.178 *Functional direction and financial control over pay administration should be strengthened by:*

- *clarifying and communicating the responsibilities and authorities of the key participants in the systems of pay administration; and*
- *ensuring that the Personnel Administration and Financial Administration Directorates have the appropriate staff resources and reporting relationships in place to provide effective functional direction.*

Control Over Source Documentation

17.179 Our examination of the controls over source documents identified a significant number of weaknesses, inconsistencies and specific cases where prescribed controls were not being enforced. An exception to this comment is the Health Protection Program which has only minor weaknesses in its systems for the control of source documents.

17.180 Detailed observations and recommendations for corrective action brought to the attention of management of the other pay centres examined dealt with matters such as: the delegation of payment authority to inappropriate persons; failure to obtain spending authority or managerial approval of overtime and other source documents; failure to validate signatures; a lack of information to facilitate the recovery of overpayments; lack of physical security over personnel and pay records; errors and omissions in the attendance, leave and overtime records; "acting" appointments and pay in effect for more than one year without the required Treasury Board approval; incomplete employee history cards; inconsistent use of forms; weaknesses in the batch control procedures; authorized documents not cancelled after processing to prevent re-submission; and unused spaces on authorized forms not cancelled to prevent the addition of information after authorization. The incidence of weaknesses indicates the need for functional direction as well as reliable supervisory controls and audit trails on source documents to ensure that all required control steps are performed without error or omission. Although these weaknesses provide opportunity for undetected error and fraud, no intentional abuse of the system was identified in over 400 payroll transactions tested in detail.

17.181 *Comprehensive standards and instructions for the financial control over payroll source documents should be developed and communicated throughout the Department.*

Payroll Accounting

17.182 The systems do not provide a practical basis for establishing the integrity of payrolls and payroll cost information in the principal accounting records. In practice, there are many timing differences between payroll authorization, payment and accounting. The current limited purpose batch controls on source documents are not designed to meet broad objectives of reconciling input totals to output. Because of timing differences and the lack of an audit trail, payrolls cannot be reconciled to financial reports and departmental officers have no alternative means of ensuring that reported payroll costs are complete, accurate and appropriately chargeable to their budgets. At the departmental and program level these weaknesses could permit systems design or processing errors by the Department of Supply and Services to pass unnoticed. At the responsibility centre level these weaknesses could permit delays, error and fraud to pass unnoticed and also inhibit the potential usefulness of all financial reports.

17.183 Alternative systems of payroll accounting drawn from conventional concepts of time reporting or standard costing have not been developed or made available to managers to meet their potential needs for more useful and reliable payroll costing in support of management information and performance measurement systems.

17.184 *Payroll accounting systems should be improved to provide the necessary audit trails to enable reconciliation from source documentation to the payroll records and to the principal accounting records.*

Grants and Contributions for National Welfare, Family Planning and National Health Research and Development

Program Descriptions

17.185 National Welfare Grants. In 1977-78 grants of \$1.5 million and contributions of \$4.5 million were paid under the Social Assistance Program to provinces, welfare agencies, universities and individuals in support of welfare research and demonstration projects and sustaining grants to 13 national voluntary welfare organizations.

17.186 Family Planning Grants. In 1977-78 grants of approximately \$2 million were paid, under the Social Assistance Program, to provinces, municipalities, universities, individuals and voluntary organizations for research, demonstration and training projects in the area of family planning.

17.187 National Health Research and Development. In 1977-78 contributions of approximately \$12 million were paid under the Health Care Program to persons and agencies to support research and demonstration projects in the field of public health.

Scope of the Audit

17.188 Separate reviews of these three grants and contributions programs represented a partial integration into the 1977-78 audit activities of the special government-wide survey of grants and contributions reported in Part 12 of the 1977 annual Report. These three programs were selected at random from several of the Department's smaller non-statutory grants and contributions programs that have not been dealt with elsewhere in this Chapter.

17.189 The audits were performed in 1977 and included reviews of the compliance with legislation and Treasury Board policies, the 1977-78 Estimates and budgets, the adequacy of financial controls, and

selected sample files with the supporting documentation and authorities. Detailed observations have been provided to management.

General Standards of Control

17.190 Within the three programs examined there were incidences of the same types of weaknesses reported in Part 12 of the 1977 annual Report that included government-wide observations and recommendations dealing with disclosure in the Estimates, confusion in terminology, program criteria, terms and conditions, contribution applications and agreements, monitoring and evaluation, and internal financial controls.

17.191 Our review indicated that these three programs are generally being administered in accordance with the Treasury Board policies but the detailed tests of selected cases identified weaknesses in control and exceptions to normal procedures, all of which were discussed with program officials and corrective action undertaken.

17.192 A common characteristic of the three programs is that they are administered by small groups of individuals and within these groups it is not always feasible to establish effective segregation of duties, supervisory controls and systems of accountability.

17.193 *Because of the lack of segregation of duties among program officers and financial officers within these programs, the Headquarters financial and internal audit functions should develop a program to ensure that there is effective independent monitoring of the financial controls over these grants and contribution programs.*

Medical Research Council

Description

17.194 The Council was established by the Medical Research Council Act, R.S., c. M-3, of 1969 as a departmental corporation. The Council reports to Parliament through the Minister of National Health and Welfare but operates outside the organizational structure of the Department. The Council promotes, assists and undertakes basic, applied and clinical research in the health sciences and advises the Minister on matters relating to such research. It awarded payments of \$57 million in grants and scholarships in 1977-78.

Scope of the Audit

17.195 The audit was carried out in accordance with generally accepted auditing standards to support an audit opinion on the financial statements of the Council and included an evaluation of the system of internal control and the verification of a representative sample of transactions. The scope was extended to review matters of a financial and management control nature with particular reference to grants and scholarships.

Strengths

17.196 The Council, which employs approximately 40 persons, has experienced stability of personnel and, through the prompt publication of the President's annual report, an annual Grants and Award Guide and a quarterly newsletter, all of which receive wide distribution, it has created a very visible

profile in the medical research community. There are good internal financial controls and explicit terms and conditions, approved by Council, which govern the awarding, payment and accounting for grants and scholarships. Twenty-four Review Committees assess individual applications and submit recommendations for financial support to the Executive and the Council itself approves the majority of grants and scholarship disbursements. Most payments are made through financial officers of third parties, universities or medical institutions, for payment to Council-approved recipients. Payments are made by instalment and Council requests an accounting by both the institution and the individual for a grant and by the institution for a scholarship.

Organization and Staffing of the Financial Function

17.197 The Council has not developed the organizational arrangements and procedural documentation to ensure the continued effective operation of the systems of financial management and control. Present internal responsibilities and procedures are based on tradition and the experience of long-serving staff and have not been documented. The Director of Grants, responsible for the financially most significant component of the program, has also assumed the position of Director of Administration. This is an onerous and potentially competing combination of responsibilities, and provides little time to attend to internal administrative matters such as the supervision of staff or the documentation of financial responsibilities policies and procedures.

17.198 Financial responsibilities and procedures should be comprehensively documented and there should be an experienced senior financial officer without major program responsibilities reporting directly to the President.

Observations Reported in Accordance with the Requirements of Section 7(2) of the Auditor General Act

Failure to Obtain a Contract for Electronic Data Processing Services

17.199 The Department of National Health and Welfare has developed a comprehensive, integrated computer information system which contains banked information needed for policy and program research, evaluation and planning and program administration in the social security and socio-economic fields. This system, known as ANSSIR (A Network of Social Security Information Resources), provides on request, information on an on-line basis to federal, provincial and municipal government departments.

17.200 The Department has paid \$1,776,000 over four years to an outside supplier of electronic data processing services for the development and operation of a major specialized information system, without seeking tenders or obtaining a contract, other than by National Master Standing Offer. The payments amounted to \$470,000 in 1977-78, \$413,000 in 1976-77, \$551,000 in 1975-76 and \$342,000 in 1974-75.

17.201 This omission was drawn to the attention of the Department by the Department of Supply and Services in 1975 and by the Treasury Board Secretariat in 1976 and 1977. The responsible officers have explained that they were unable to complete the detailed systems documentation for such a complex new system to the standards required to request tenders in accordance with the Government Contract Regulations.

17.202 Preparation of the required detailed systems documentation, which began in 1976, has now been completed, a Request for Proposal has been issued, and the review of tenders is expected to be completed and a contract signed by April 1, 1979.

Summary of Recommendations and Department's Comments

Recommendations

Role of the Financial Function

17.41 The role of the financial function should be clarified and the implementation of the newly established policies closely monitored to ensure that:

- they are appropriately interpreted and applied in practice;
- the Assistant Deputy Minister, Administration, is able to perform the functions of senior financial officer effectively; and
- the responsibilities, organizations and staff of the Director General, Financial Administration and the Director of Internal Audit fully support the responsibilities of the Assistant Deputy Minister, Administration and enable him to provide comprehensive, objective advice on departmental resource management.

Department's Comments

Agreed. The draft policy statements on the organization of the financial administration function will, when approved by the Executive Committee, provide a clear and accepted basis on which the Assistant Deputy Minister, Administration, and his key financial officers can perform effectively.

Recommendations

17.42 The appropriateness of the existing organizational arrangements should be subject to a comprehensive review after a suitable trial period.

Department's Comments

Agreed.

Recommendations

17.47 A comprehensive plan should be developed to identify needs, establish priorities and make improvements to the financial management, control and performance measurement systems.

Department's Comments

Agreed.

Recommendations

17.50 To the extent that the role of the financial function may be better understood and accepted throughout the Department, consideration should be given to revising the titles of senior financial officers; the titles, Departmental Comptroller and Branch Comptrollers are suggested.

Department's Comments

An assessment of the adequacy of the titles of senior financial officers at the departmental and branch levels will be incorporated in the review mentioned in paragraph 17.42.

Recommendations

Internal Audit

17.65 The Internal Audit Directorate should continue its efforts to ensure that:

- all authorized man-years are used; and
- it acquires appropriate EDP audit capability.

Department's Comments

The Directorate has developed a staffing plan which is being executed and, as in the past and current year, all authorized man-years will be used.

As part of the staffing plan the EDP audit capability has been improved and provision made for special audit orientation and training sessions.

Recommendations

17.67 The Directorate should re-examine and amend its plans for the benefit payment systems audits to:

- ensure that the Directorate has a comprehensive understanding of the payment systems before any aspect of the field work is contracted out to Audit Services Bureau or others;
- ensure that it has an appropriate involvement in systems amendments; and
- detail the nature and extent of the coverage necessary to ensure that key elements of all systems are audited annually.

Department's Comments

The Directorate's plans have been amended and it intends to acquire a comprehensive knowledge of the payment systems prior to contracting out. In fact, this is being pursued during the audit of the Alberta Region, Income Security Programs Branch, this year.

The Directorate's revised role statement provides for involvement in systems design and amendments.

Determination of the nature and extent of coverage necessary is an integral part of the operational plan for the acquisition and development of an EDP audit capability in the Directorate.

Recommendations

17.70 The Directorate should regularly evaluate all audit activities under the direct control of program officials, including the work of any contracted audit groups involved in the verification and control of contributions.

Department's Comments

Program officials currently provide the Directorate with copies of contracts, prior to signing, between the Department and any external agency. As part of normal audit coverage the Directorate examines the adequacy of audits performed on behalf of program officials. In addition, guidelines are being developed to assist program officials in establishing suitable standards and scope in contract audit work.

Recommendations

17.71 The Directorate should communicate with legislative auditors whose work is being relied on by the Department.

Department's Comments

The Directorate has had communication with legislative auditors when circumstances required it. The Directorate is prepared to continue this action in any set of circumstances in which it would appear beneficial. In normal circumstances, however, the regular line of communication through program officials should continue.

Recommendations

17.73 The Internal Audit Directorate should update its manual and procedures emphasizing the need to strengthen and maintain documented evidence of supervision and file review to provide greater assurance that significant areas of audit or audit observations are not omitted.

Department's Comments

The Directorate's revised Handbook of Standard Practices and Procedures will contain specific instructions to meet these requirements.

Recommendations

Canada Pension Plan Contributions and Benefits Controls

17.83 Controls over implementing and maintaining computer systems and files should be improved to ensure that:

- existing computer programs are properly documented;
- all systems and program amendments are subject to appropriate authorization and controls by the responsible users, systems analysts, data processing management and financial officers; and

- adequate arrangements exist for emergency computer processing and offsite storage of backup files.

Department's Comments

Agreed. Certain improvements in control procedures and documentation have already been made; others are currently being implemented or are under study by the Department of Supply and Services and this Department. Negotiations to acquire emergency computer back-up and off-site storage are in process.

Recommendations

17.89 A study should be made to examine the benefits and costs of alternative ways of improving the manual and computer controls over contributory earnings records and of identifying and correcting any errors that may be on file. Manual and computer program controls should be introduced to ensure that:

- all error corrections will be authorized by persons other than those involved in submitting corrections and after batching or equivalent accounting controls have been established;
- independent check and reconciliation procedures are maintained to confirm that the number and dollar value of transactions received from National Revenue - Taxation will be accounted for after the final update of the earnings and contributions master file, and the detailed contribution records will be in agreement with the monies received and the principal accounting records;
- reconciliations and key control conditions will be checked by independent staff and reviewed and approved by supervisors; and
- policies procedures and controls will be comprehensively documented and communicated to the staff involved and applied in practice.

Department's Comments

Agreed in principle. The cost and benefits of alternative courses of action to improve existing controls are now being studied jointly by this Department and the Department of Supply and Services. This includes improvements in areas such as authorization of error corrections, review of reconciliations and key controls, and documentation of policies, procedures and controls.

The implementation of the recommendation concerning the reconciliation of contributions and earnings involves this Department and the Department of Supply and Services, National Revenue-Taxation, and Finance. The extensive systems and procedural changes which would be required to implement the controls recommended are now being assessed.

Recommendations

17.92 Accounting or batch controls over benefit applications and change orders should be established before authorization of these input documents and the important reconciliations of input control totals to updated master files and the principal accounting records should be subject to independent check and supervisory approval.

Department's Comments

Insofar as controls over benefit applications and change orders are concerned, the Department will study the recommendation to determine whether the recommended or other compensating controls should be introduced. The Department agrees with the recommendation pertaining to independent check and supervisory approval.

Recommendations

Family Allowance and Old Age Security-Benefit Controls

17.99 Document and accounting controls should be established before the key steps in the verification and authorization process and, where this is not economic or feasible, post-audit programs to monitor the significance of the weaknesses should be improved.

Department's Comments

Agreed.

Recommendations

17.101 Controls over reconciliations and follow-up procedures on exception reports should be made more reliable through improved procedural documentation, training and supervisory review.

Department's Comments

Agreed.

Recommendations

17.103 Procedures should be developed to confirm that control over standing data on computer files is being properly maintained, including measures such as:

- systematically test-checking selected records of beneficiaries to source information; and
- Periodically scanning the master benefit files for unusual items.

Department's Comments

Agreed. A number of steps have already been taken to systematically assess the validity of data on computer files, including measures such as those recommended. Continued strengthening of these control mechanisms is under way.

Recommendations

Canada Assistance Plan

17.126 The plans and progress of program officials in giving effect to legislative changes should be independently reviewed and periodically monitored to ensure that all practicable action is being taken to expedite and maintain control over the establishment of cost information required.

Department's Comments

The Department agrees that an independent review of the financial administrative aspects of action being taken to effect legislative changes is justified.

Recommendations

17.133 Subject to the need to obtain and allocate experienced staff resources, management should initiate a program to:

- develop comprehensive systems documentation relative to the public assistance program that will continue under the Canada Assistance Plan;
- provide more active direction and supervision to the contract audits performed on behalf of program management;
- ensure that the work of Field Representatives and contract auditors are reviewed by Departmental Internal Audit; and
- ensure that there is an effective, independent monitoring process to confirm that program management continues to take all possible effective action to ensure program and client eligibility, resolve unsettled accounts and recover overpayments.

Department's Comments

The Department agrees in principle with the first two parts of this recommendation. Subject to the availability of resources, plans for improving documentation and clarifying direction to contract auditors will be developed within the next twelve months. In terms of priority, program management must first consider the costing problems associated with the two new major legislative actions (Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, and the Social Services Financing Bill tabled in the House of Commons in May 1978).

Internal Audit Directorate will continue its cyclical reviews of the work of Field Representatives and contract auditors, and the scope and frequency of these reviews will be increased as a result of the recent augmentation of Internal Audit resources. In addition, the Internal Audit Directorate will continue to support activities of program management, by providing advice regarding audit policies and audit contracts, as required.

The Director General, Financial Administration is responsible for ensuring that financial controls are developed and are in place in this regard. The normal management process involving:

- a. interaction of program management with the Assistant Deputy Minister, Social Service Programs Branch and the Deputy Minister;
- b. cyclical reviews by the Internal Audit Directorate; and
- c. periodic assessment of the adequacy of the system of financial controls;

is considered sufficient for the purpose of ensuring that program management is taking all possible effective action on an ongoing basis.

Recommendations

Health Care

17.143 Payments made under the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977 and allocated to the Health Care and Post-Secondary Education Programs, should be supported in the Estimates and Public Accounts by a comprehensive schedule providing cash and non-cash costs and comparative information reflecting payments under the previous fiscal arrangements for Hospital Insurance, Medical Care, Extended Health Care Services and Post-Secondary Education.

Department's Comments

Agreed in principle. This recommendation will be brought to the attention of appropriate officials of the departments and central agencies concerned.

Recommendations

Medical Services

17.155 The budget preparation process should be strengthened by:

- improving the central directions to be followed in preparing operational budgets, standards of financial analysis and information to accompany budget submissions, policies and guidelines on program matters, such as the nature and level of services to be provided; and
- ensuring that the Branch Financial Adviser is responsible for performing a detailed review and challenge of budget documentation to establish the reliability of the information as a reflection of operating plans and as a basis for establishing accountability and monitoring performance.

Department's Comments

Extensive inter-branch and interdepartmental consultations are being conducted continuously with the aim of improving policies and guidelines on program matters. For example, these consultations have recently resulted in the promulgation of a revised policy on non-insured medical care costs under the Indian Health Services Activity.

Guidelines to branch managers establishing the methodology for budget submissions and the required standards of financial analysis are reviewed annually and discussed in detail at Regional Financial Workshops and Regional Directors' meetings. The Branch recognizes that further improvements are possible in this area.

The role of the Branch Senior Financial Officer in supporting the detailed review of budgets by senior program managers is recognized. For example, senior program managers and the Branch Senior Financial Officer have recently performed an exhaustive review of branch operational budgets wherein all regional budgets and operational plans were rigorously challenged. A group of senior program managers, chaired by the Branch Senior Financial Officer reporting to the ADM, continues to review and challenge all resource allocation submissions for the Branch.

Recommendations

17.157 Revenues for hospital care recovered from provincial hospital insurance plans should be under continuous review and analysis by the Branch Financial Officer to ensure that:

- Regional Management involved in negotiating per diem and service rates is provided with complete and accurate cost information; and
- possible inequities or anomalies in per diem and service rates are brought to the attention of senior branch or departmental officials.

Department's Comments

Regional Management have always been provided with complete and accurate cost information in this regard, and will continue to be so provided as an integral part of the financial administration of the region.

Resolution of inequities or anomalies in per diem and service rates is achieved through continuous negotiations in the normal Federal-Provincial consultative process.

Recommendations

Fitness and Amateur Sport

17.162 The role of the Branch's financial function should be closely monitored to ensure that planned systems improvements are effectively implemented and that the function will receive the necessary leadership and staff support in the future.

Department's Comments

The Director General, Financial Administration will continue to work closely with Branch personnel in this regard. Monitoring of the development of systems improvements will continue as implementation progresses to ensure that financial controls are strengthened, and that sufficient resources are available.

Recommendations

17.166 The procedures for performing and monitoring the verification of contributions should be based on:

- formal agreements with recipients specifying the terms and conditions of the contributions;
- formal plans and audit programs to ensure consistent and objective standards of audit; and
- formal reporting procedures and supervisory controls to ensure that audit activities remain timely, any required corrective follow-up action is taken, and the results of the audit activity are communicated to Branch officials.

Department's Comments

Agreed. Subsequent to the Auditor General's audit, the Branch has adopted a policy of requiring written acknowledgement from recipients in the form of agreements specifying terms and conditions of the contributions.

In addition, Branch audit plans and work programs are being improved and formal reporting procedures and supervisory controls are in place to ensure that available audit resources are used as effectively as possible.

Recommendations

17.168 Financial policies, responsibilities and procedures should be comprehensively documented and communicated in manuals for use within the Branch and by recipients of contributions.

Department's Comments

Agreed.

Recommendations

17.172 Further improvements to the budgeting, project approval and management information systems should ensure that:

- activity classifications, project accounting records and organization structures are effectively integrated so the financial responsibility and authority of program officers can be established and monitored;
- budgets are comprehensive and as clear a reflection of objectives, operating plans, resource allocation decisions and criteria for measuring performance as is feasible at the time of their preparation;
- the senior financial officer will be in a position to provide the Assistant Deputy Minister with more complete and reliable advice and information on all financial matters; and
- appropriate consideration is given to potentially more efficient ways of directing financial support than the existing project-based contributions, to recipients with good planning and financial management systems.

Department's Comments

Subsequent to the Auditor General's audit, a new activity structure has been approved by the Treasury Board Secretariat and this structure, combined with the new contribution control process will effectively establish financial responsibility and authority of program officers. In addition, revised budgeting and reporting procedures are being developed in order to provide the basis for more effective integration of objectives, plans, budgets, resource allocation decisions and performance measurement, and hence improve the financial advice and information available to senior management.

The Branch is initiating a project to identify and assess the practicality of alternatives to project based contributions.

Recommendations

Payroll

17.178 Functional direction and financial control over pay administration should be strengthened by:

- clarifying and communicating the responsibilities and authorities of the key participants in the systems of pay administration; and
- ensuring that the Personnel Administration and Financial Administration Directorates have the appropriate staff resources and reporting relationships in place to provide effective functional direction.

Department's Comments

Agreed. The Department is in the process of clarifying the roles and responsibilities of managers, personnel officers, and financial officers with respect to pay administration, as part of its overall response to T.B. Circular 1977-37. Discussions with T.B. officials, concerning the transfer of resources to the Department in order to carry out the verification of pay input documents required by the T.B. Circular, are still in progress. Also the Department will examine the additional resource requirements necessary to provide more effective functional direction.

Recommendations

17.181 Comprehensive standards and instructions for the financial control over payroll source documents should be developed and communicated throughout the Department.

Department's Comments

The need for improved documentation and training and control has been recognized and work is under way in this area.

Recommendations

17.184 Payroll accounting systems should be improved to provide the necessary audit trails to enable reconciliation from source documentation to the payroll records and to the principal accounting records.

Department's Comments

While this recommendation is theoretically sound, the Department has not yet established whether design and implementation of improved audit trails and reconciliation procedures envisaged by the Auditor General is practical. This is a low priority item in relation to other work to be done in the pay administration area.

Recommendations

Grants and Contributions for National Welfare, Family Planning and National Health Research and Development

17.193 Because of the lack of segregation of duties among program officers and financial officers within these programs, the Headquarters financial and internal audit functions should develop a program to

ensure that there is effective independent monitoring of the financial controls over these grants and contribution programs.

Department's Comments

The Department acknowledges that at the time of the audit there was a lack of segregation of duties in some of these programs; however, this problem was subsequently resolved. Financial controls are already assessed annually by the Director General, Financial Administration, as part of an established program to review and update financial signing authorities.

Recommendations

Medical Research Council

17.198 Financial responsibilities and procedures should be comprehensively documented and there should be an experienced senior financial officer without major program responsibilities reporting directly to the President.

Department's Comments

A financial administration manual is in preliminary draft form. A senior financial officer reporting to the President and without major program responsibilities would be desirable but is not immediately feasible. In view of current restrictions on expansion implementation will necessarily be deferred.

1978 Report of the Auditor General of Canada - Chapter 18

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Department of National Revenue - Customs and Excise</H1>

</CENTER>

<HR>

Summary of Findings, Observations and Recommendations

Introduction

18.1 This Chapter of my Report contains the principal observations and recommendations arising from the current year's audit and an outline of the Customs revenue operations and certain important perspectives considered in reaching our findings.

18.2 This Department's cyclical audit has been planned to include coverage under all provisions of the Auditor General Act, carried out throughout the Department over a three-year period.

18.3 The Department's expenditure systems (of which personnel cost is the prime component) are not included in this examination since they were reported on in 1975 as part of the Financial Management and Control Study (FMCS) undertaken by this Office. They will be dealt with at a later date.

18.4 Further, this Office intends to continue to monitor and follow up on recommendations made in previous years and to report on implementation progress.

18.5 We provided the Department with a detailed management report containing an in-depth treatment of the findings, analyses and recommendations of our audit.

18.6 We would like to acknowledge and express our appreciation for the Department's co-operation during the audit. The willingness of the executive and staff at all levels to discuss the issues with the aim of improvement not only greatly facilitated the conduct of our audit but should also contribute significantly to the benefits that can flow from implementing our recommendations.

18.7 The Department's participation in the statistical determination of the assessment revenue gap, by assembling data requested and re-appraising declarations, proved a valuable contribution to the audit, as did the invitation extended to us to be privy to the deliberations of the Department's Financial Management Task Force and to offer our comments on the courses of action then under consideration.

Overview of Customs Operations

Background

18.8 The present Department of National Revenue was established in 1972 under the provisions of the Department of National Revenue Act, *R.S., c. N-15*, with two components -- Taxation, and Customs and Excise. A Deputy Minister heads each and they operate administratively as independent departments.

18.9 The taxes imposed by Customs and Excise are primarily commodity oriented, i.e., taxes and duties imposed on the importation and the sale of goods. A distinction exists, however, between the types of duties imposed by Customs and those imposed by Excise. The duties imposed by the Customs Tariff, *R.S., c. C-41*, and Anti-Dumping Act, *R.S., c. A-15*, are primarily protectionist in nature, designed to protect Canadian industry by imposing tariff barriers where appropriate. The duties and taxes imposed by Excise are primarily oriented towards revenue.

Organization

18.10 Under a reorganization that was announced on October 1, 1976, Customs was divided into two main Branches:

- Customs programs: This Branch, headed by an Assistant Deputy Minister, develops policies, programs and systems to provide for the efficient and uniform application of the Customs Act, *R.S., c. C-40*, the Customs Tariff, the Anti-Dumping Act and the Countervail and Surtax Regulations. It also accepts responsibility for the enforcement of other legislation and regulations by Canada Customs personnel as a service to other departments and agencies. The senior personnel of the Branch exercise functional authority over the Field Operations Branch staff on all aspects of the Customs program and encourage input from Branch personnel in developing effective systems and procedures. The Branch consists of four Divisions: Tariff Programs, Special Assessment Programs, International Traffic Programs and Customs Programs Branch Services. Its staff is located in Ottawa, except for a small group of offices in foreign countries.
- Field Operations: Also headed by an Assistant Deputy Minister, this is the large operational Branch of Customs. Within the framework of departmental policies, it is responsible for operating the systems and procedures principally designed by the Customs Programs Branch relating to the assessment and collection of import duties and taxes, and the examination and release of goods, persons and vehicles entering or leaving Canada. It provides service to the importing public through a headquarters and regional organization with more than 650 locations. Customs ports, outports and vessel clearing stations are located at various inland centres, as well as at seaports, frontier ports and major airports across Canada.

18.11 General administrative support is provided to the above Branches and Excise by a group of functions consisting of Finance and Administration, Personnel Administration, Legal Services, Planning and Consulting Services, Public Relations and Information Services and Internal Audit. The staffs are located primarily in Ottawa.

Financial and Other Data

18.12 A breakdown of the expenditure and man-year figures for Customs and Excise activities, taken from the 1976-77 Public Accounts and Main Estimates, shows:

Activities	Expenditure (\$ millions)	Man-years
Customs programs	10.9	503

Field operations	127.1	7,112
Excise	33.4	1,647
General administration	15.2	478
	<u>\$ 186.6</u>	<u>9,740</u>

18.13 A breakdown of the revenue collected by Customs and Excise for 1976-77, as reported in Public Accounts, shows:

	(\$ millions)
Customs import duties	\$ 2,097.5
Excise duties and taxes	1,949.2
Sales tax	3,928.8
Miscellaneous revenue	<u>10.2</u>
	<u>\$ 7,985.7</u>

18.14 In addition to its revenue collection responsibilities, Customs carries out a number of other activities. These include controls over the importation of prohibited goods and substances and over the movement of people entering the country, aimed at protecting Canadian industry and society. Both the revenue and non-revenue aspects of operations create major challenges. The Department must establish control systems that will meet the challenges, at the same time remaining responsive to the needs of the public.

Summary of Audit Office Activities

18.15 Our audit focused on Customs, with particular emphasis on the procedures and practices used to control the following functions, each a critical element in the general process of collecting revenue:

- examination and control of inland movement of goods;
- cargo control documentation;
- collection and cash handling;
- bonded warehouse operations;
- assessment;
- drawbacks, refunds and remissions;

- investigations;
- the automated Cargo Entry Processing and Collection System (CEPACS); and
- internal audit.

18.16 Under the Auditor General's new mandate on value-for-money auditing, one area of our audit concentrated on management controls in Customs. Another examined control over the declaration of commercial imports, including the extent of controls covering:

- the physical examination of commercial goods;
- carriers permitted to transport imported goods inland from the border (under seal) without examination; and
- practices and procedures the Field Operations Branch follow from the point at which ports of importation receive documents used to advise Customs of an import, to the point at which revenues collected have been deposited in the bank and the transaction concluded.

18.17 The Department has embarked on an extensive program of computerization for processing certain import documentation and declarations. Although the computerized system was only operational in one region at the time of our audit, departmental plans call for its eventual implementation across Canada. Certain aspects of this system, which is known as the Cargo Entry Processing and Collection System (CEPACS), were examined as part of our audit. These aspects include the organizational, management and planning controls connected with the system's development, the internal controls it provides for and certain considerations concerning further implementation of the system across the country.

18.18 The quantification of probable revenue loss in declaration, assessment and collection is an important element in assessing the cost effectiveness of alternative control mechanisms. Accordingly, our audit included a statistical test, designed to measure the difference between the revenue actually collected and that which the Department's assessment function might have identified.

18.19 In addition, we included as part of the audit a review of the internal audit function of Customs and Excise, with primary emphasis on the audit of Customs activities, to determine the extent to which:

- the recommendations of the Financial Management and Control Study in 1974-75 have been adopted and implemented; and
- the internal audit function, in terms of the way it is currently organized and carried out, forms an effective part of the managerial control system, commensurate with our evaluation of the Department's needs in this area.

Extent of Audit

18.20 We examined the controls in each of the functions listed in paragraph 18.16 in the Vancouver and Hamilton regions and at the Department's Headquarters in Ottawa. We also conducted reviews in the Montreal, Toronto and Halifax regions for those functions listed in paragraph 18.15 with less

comprehensive reviews in the Ports of Ottawa and Hamilton. The audit was conducted principally during the period from September 1977 to May 1978.

18.21 We interviewed appropriate personnel at all levels in the regions visited and at Headquarters. In addition, we examined supporting documentation, studies done previously by departmental and outside groups and the reports of the Financial Management Task Force.

18.22 Other than the testing described in paragraph 18.18, we conducted only sufficient tests to confirm the information about controls obtained through the interviews and examinations. These tests were not of sufficient depth to enable us to determine the extent to which individual internal controls were operating in a reliable manner.

18.23 At the time of our audit, the Department had identified a number of areas as requiring improvement and was developing or implementing new and revised procedures in certain cases. These involved substantial alterations in Drawbacks, Refunds and Remissions, as well as Accounts Receivable and Internal Audit. Although our audit did not attempt to evaluate these new or revised systems in detail, it did include an examination on whether they would be capable of remedying the control deficiencies observed in the existing systems.

Scope Exclusions

18.24 Our audit was designed to highlight areas where risk of fraud, error or abuse is high. It was not designed to uncover specific instances where these may have occurred or where fraud may have been involved because controls were nonexistent or had been poorly designed or applied.

18.25 Certain audit tests could not be carried out because in some cases key documents are normally destroyed as a part of the system's routine. Their destruction precluded any post-audit of how they were treated initially.

18.26 Because our audit focused on revenue systems, it concentrated on activities that collect the bulk of Customs' total revenue -- duty and taxes on commercial goods imported into Canada. The audit did not deal with what is perhaps the more conspicuous part of Customs operations, the enforcement of regulations covering Canadians returning from outside the country or foreign visitors entering Canada.

The Customs Environment

18.27 Our audit sought primarily to assess the adequacy of the Department's policies, rules and procedures in providing an effective control over the assessment, collection and allocation (accounting classification) of revenue from Customs activities and to determine whether essential records had been maintained.

18.28 To place our findings in their proper perspective, it is important to consider the potential exposure to errors, abuse and internal or external fraud due to the absence of certain controls or deficiencies in applying existing controls within the environment in which the related activities are carried out. With these considerations in mind, the cost of maintaining or introducing certain controls can be weighed against the benefits to be derived from them. Such benefits can be measured in terms of extra dollars of revenue collected, reduced risk of error or fraud and other factors management considers relevant.

18.29 This section does not attempt to analyse the effectiveness of specific controls. Its purpose is to set out matters which add to the basic risk factor of Customs activities, because they are inherent in the very nature and history of the Canadian Customs operations, including the need to avoid controls that would reduce the level of service to the importing public. By bringing all these considerations together in one section, it is possible to indicate the nature of the environment in which much of the related revenue assessment and collection activities are carried out and thus the need for more extensive or more effective controls or both.

Voluntary Compliance

18.30 The Estimates define the objective of the Customs and Excise Program as "to assess, collect and control duties and taxes on imported and domestically produced goods and exercise control over international movements of persons and goods". Although no attempt has been made to define precisely the degree of control to be exercised, presumably the Department is expected to pursue the Program objectives within cost-effective means and within overall government policy.

18.31 As in other countries, the Canadian Customs system is based on voluntary compliance with applicable laws, regulations and procedures by importers, their agents, carriers and others. The system requires those subject to Canadian Customs laws (including tariffs and numerous other provisions) to report to the appropriate authorities that goods are being imported, to make a self-assessment of the applicable duties and taxes, to answer questions truthfully and to make the appropriate payment.

18.32 Because of the complexities surrounding the legislation and regulations that apply to the importation of goods, importers and their agents are bound to make unintentional errors in attempting to interpret and meet requirements. In addition, there will be conscious efforts on the part of certain members of the importing public to escape applicable duties and taxes unlawfully or to abuse the system otherwise.

Accordingly, the Customs system is designed to:

- encourage full and accurate compliance and to deter those who may be tempted to escape duties and taxes deliberately;
- detect errors made by the importing public and obtain payment of the appropriate duties and taxes; and
- detect deliberate fraud or abuse and impose appropriate penalties.

18.33 Customs examination, appraisal and review are done on a selective basis. This "selective" process, coupled with the natural tendency for importers to attempt to minimize their liabilities, presents a real challenge to those who must enforce a "voluntary" system.

Enforcement and Clearance

18.34 The Customs system must be capable of collecting the import duties and taxes due the Government without causing undue delay in the movement of goods, which could have a detrimental effect on importers who need them to carry on business. Thus, the system must be responsive, but it must also provide an acceptable level of control, all at reasonable cost.

18.35 Since responsiveness normally decreases as control increases, striking an appropriate balance between the two involves a great deal of judgment and the careful selection of appropriate controls.

Other Factors

18.36 A number of other aspects of Customs operations make the establishment of effective controls more difficult. These include:

- the geographic dispersion of Customs ports necessary to meet the needs of the importing public (over 650 locations);
- changes in transportation technology, such as the advent of containerization and jumbo jets, which increase the time and the cost of carrying out the Customs function to a point where certain traditional controls are no longer effective and there is a tendency to reduce the extent of examinations, thereby increasing the risk factor;
- the existence of small ports, often staffed by one or two employees, precluding the use of segregation of duties as a control; and
- the complexity of rules, procedures and legislation, many involving a high degree of judgment in their interpretation and application to a wide variety of imported goods.

18.37 Each of the foregoing factors, along with the sheer volume of entries processed by Customs' staff, adds a dimension of complexity. Customs must be capable of coping with these high-risk factors within a collection framework that depends on voluntary declaration and self-appraisal, and in which it has only limited control over other participants, such as carriers and brokers. Intelligence arrangements with law enforcement agencies and information provided by the public at large could have the effect of mitigating to some degree the amount of exposure to error or fraud. Although the impact of none of the above factors has been specifically determined it is clear that Customs operates in an environment in which there is substantial exposure to error or fraud, internally and externally.

General Assessment

18.38 The Department has made a number of organizational changes designed to enable it to cope better with the challenges it faces. It has taken steps to remedy certain deficiencies it identified in financial management and control and it is also taking steps to increase its ability to cope with a major increase in the volume of work through an extensive program of computerization. At the time of our audit, the Department had identified the need to review a number of areas commented on in our report.

18.39 While these represent positive steps, there is still considerable scope for further improvement in the Department's management and control systems, particularly in:

- determining what effect the absence of certain individual controls or groups of controls may have had on revenue received;
- assessing existing Customs procedures and practices to find out how much of the total revenue which can be collected is being collected (i.e., the effectiveness of the program), as well as the degree of success the Department is having in enforcing other Acts;

- developing a system for measuring the economy and efficiency of Customs activities;
- establishing or amending, based on the above, procedures and controls to capture the greatest amount of revenue at the least cost; and
- providing management with proper support through the internal audit function.

18.40 Successfully addressing the above matters could provide significant short and long-term benefits to the Department by:

- helping to establish better accountability within the Department and on a government-wide basis through performance measurement systems;
- providing information that would help to maximize revenue collection; and
- helping the Department to cope with present and increasing volumes within an environment of resource constraints.

Study of Procedures In Cost Effectiveness

18.41 The Study of Procedures in Cost Effectiveness focused on the Department's ability to manage its resources in enforcing the various Acts and Regulations on importation of commercial goods.

18.42 The questions posed to departmental management were designed to determine the extent to which satisfactory procedures have been established to measure and report on the effectiveness of the Customs sub-program and whether appropriate information is available to help managers make decisions with due regard to economy and efficiency.

Measurement of Program Effectiveness

18.43 Under the self-assessment system, those responsible for controlling commercial imports should know:

- the amount of revenue from import duties and taxes which with 100% compliance theoretically could be collected by Customs compared to that actually received; and
- the Department's effectiveness in enforcing other Acts which are not revenue oriented but play an important role in protecting Canadian industry and society.

18.44 These factors are central to the measurement of the Examination and Control of Commercial Operations sub-activity of Customs. Although the Department established objectives for the Customs sub-program, it did not develop effectiveness indicators for the sub-activity and the major operations it comprises such as examination, assessment and investigation.

18.45 Effectiveness indicators can be used for more than assessing performance. They also aid in the allocation of resources among operational components, in determining the optimum enforcement balance and in assessing the impact on operations of accepting responsibility for new or revised legislation.

18.46 The Department's mandate to control the international movement of goods also gives it an administrative or enforcement role for legislation that is primarily the responsibility of other Government departments. The enforcement of the Customs, Customs Tariff, Excise, *R.S., c. E-12*, Excise Tax, *R.S., c. E-13*, and Anti-Dumping Acts are of primary concern to the Department, although there are over 50 other Acts for which the Department accepts some enforcement responsibility, such as The Canada Shipping Act, *R.S., c. S-9*, The Animal Contagious Diseases Act, *R.S., c. A-13*, and The Canadian Commercial Corporation Act, *R.S., c. C-6*. The degree of effectiveness the sponsoring Department requires is not defined and there is insufficient effort to measure effectiveness.

18.47 To measure the effectiveness of the Examination and Control of Commercial Operations sub-activity, the Department must be able to:

- determine how well it "enforces" these Acts; and
- ascertain whether it collects the "correct" revenue.

18.48 The Department designed systems and procedures to verify the accuracy of revenue actually collected with respect to individual importations and to help detect undeclared revenue which would otherwise not be collected. However, the Department did not measure what portion of revenue potentially available was in fact being collected. Our audit, conducted with the assistance of departmental staff, demonstrated that practical means are available to measure the effectiveness of the assessment function. Similar tests could be applied to measure the effectiveness of the Department's other operations, such as examination of goods, investigations, the post-audit carriers system and draw-backs and refunds. The findings from a test conducted by our Office in the assessment area to determine the difference between revenue collected and revenue which could have been collected are described in detail later in the Report in paragraphs 18.102 to 18.110.

18.49 The above measures would also provide an indication of the success of the voluntary compliance system, keeping in mind that this success is also influenced by the quality of information provided to the commercial public and other system participants.

18.50 *The Department should develop effectiveness indicators for the Examination and Control of Commercial Operations sub-activity so that its contribution to program objectives can be measured.*

Measurement of Operational Performance

18.51 In a highly labour-intensive operation such as Customs, the development and use of systems to measure efficiency is essential for effective control.

18.52 Since 1970 the Department has been actively engaged in defining performance measures. Standard operating procedures have been developed for most of the tasks involved in performing the Customs role. For each standard operating procedure, also termed a subordinate indicator, the Department has developed engineered performance standards. It also has developed a single performance indicator for the Examination and Control of Commercial Operations sub-activity -- the time per commercial entry. However, comparison of the value of this performance indicator to that of the base year is not meaningful since the mix of the subordinate indicators from which it is formed may change over time. Thus the value of the indicator and the reported performance may change although efficiency may or may not have changed.

18.53 Although the Department made an effort to record and communicate performance measurement data, it achieved only limited success. Managers generally made little use of such data because the form and content of the reports did not facilitate detailed resource allocation decisions. Consequently, management personnel at all levels, from the ports to Headquarters were not receiving adequate information on the efficiency of the operations for which they were responsible.

18.54 The lack of success of the program to measure operational performance can be attributed to many factors, including:

- the failure to keep the work standards current;
- the failure to establish a means of adjusting the performance indicator to reflect the changes in the mix of the subordinate indicators; and
- the questionable validity and utility of the management information data.

18.55 The Department has recognized the above issues and is attempting to address them as it reconsiders its approach to performance measurement.

18.56 As part of the Department's current efforts to develop a revised approach to performance measurement, it should place greater emphasis on clearly defining appropriate outputs and establishing work standards at a number of key work locations which will contribute to the development of a set of national standards and to the improvement of management reports.

Controls in the Customs Revenue System

Controls Over the Examination and inland Movement of Goods

18.57 The declaration process is the first step in controlling imported goods. It consists of the work associated with clearing goods, from their entry into Canada to the presentation of documentation by brokers or importers requesting their release. The basic method of identifying discrepancies between the goods declared and the goods imported is to examine the goods to verify that they conform to the entry documents. Physical examination requires that appropriate facilities be available to carry out examinations and are, along with the number of inspectors available, a determining factor in the number of examinations done.

18.58 There is no systematic approach in selecting goods for examination. For example, the examination of highway trucks depends on the judgment of the individual Inspector and the physical facilities available for examination, without the use of statistically valid sampling techniques. Inclusion of the latter would help make it possible to quantify the impact of increased or decreased examination. In addition, the intelligence data that the Customs Inspector requires on carriers, importers and brokers is not available in a comprehensive form.

18.59 Documentation of inspection results is not sufficiently detailed and the Customs Inspector does not always report information to the Commodity Specialist even though there are procedures in this area. Therefore, the assessment of goods for duty and taxes, sight unseen, may not be correct. In summary, management at any level has insufficient information for measuring the effectiveness of the examination process, or for deciding on the most effective deployment of inspection resources, although port managers by providing for proper supervision are in a position to determine the quality of individual examinations done by Customs Inspectors.

18.60 Certain major highway carriers are granted the status of "post-audit carrier", enabling them to transport goods into the country without examination at the border. Control of the post-audit carrier is exercised through spot checks of the loads at the inland warehouse and audits of the carrier's records.

18.61 Because of the post-audit procedures, fewer examinations are undertaken on these carriers than on others. Weaknesses in the post-audit system include inadequate staffing of the post-audit team, no audit manual, lack of EDP expertise and methodology limitations. These weaknesses in control over the post-audit carriers provide the potential for undetected fraud or importation of items without payment of duty or taxes.

18.62 We have also advised the Department of control weaknesses in other areas of the declaration process. These are mentioned in the next sub-section of this Chapter. The weaknesses in the declaration process, coupled with the lack of information on the results of the examination process, mean that the Department does not know if there is a significant discrepancy between the goods being declared and the goods being imported.

18.63 *The Department should:*

- *evaluate alternative approaches to conducting the examination selection process to determine the most appropriate method of measuring non-compliance. Such approaches could be based on a combination of statistically valid sampling techniques, profiles and intelligence information;*
- *develop an improved system of documenting the results of the examination process and ensure that it is implemented consistently on a national basis. This information should form the basis for improved communication between the Customs Inspector and the Commodity Specialist;*
- *reevaluate the post-audit carrier system to determine whether it achieves acceptable levels of effectiveness in detecting and deterring error or fraud; and*
- *establish selective tests to determine the impact of weaknesses in the declaration process and the most cost-effective method of implementing controls.*

Cargo Control Documentation

18.64 Cargo control documents represent the initial evidence in support of goods imported into Canada. They are a critical component in the entire Customs revenue collection system. A strong, well defined system of control is necessary to ensure that an accurate inventory of goods is maintained until subsequently acquitted by declaration and payment. The geographic dispersion of Customs operations hinders the development of an effective system to achieve these objectives since documents from many points are presented to the various ports in a random manner, precluding the use of number sequences as a control.

18.65 Fundamental weaknesses exist in the procedures for establishing control over the receipt and disposition of documents at inland ports of clearance. These weaknesses increase the risk of revenue loss due to the Department's inability to ensure that control files are complete.

18.66 The Department has neither adequate physical security nor sufficient access restrictions over its cargo control file system. For an open file system such as this, these controls are essential.

18.67 Certain deficiencies in acquittal procedures reduce the certainty that all acquittals are valid and that all outstanding documents have been properly followed up. These deficiencies include the destruction of documents, preventing an assessment of the integrity of the matching process; limited supervision; restricted use of reconciliations of input and output of documents; and limited reporting to management.

18.68 Lack of control at this stage in the Customs clearance process affects controls throughout the system. Prompt action is required to remedy the present conditions.

18.69 *The Department should assess the impact of existing control weaknesses on revenue collection and re-evaluate the control needs in this area, with emphasis on document control, supervision, reconciliation and reporting.*

18.70 *The Department should provide better physical safeguards over open cargo control document files and provide that key documents be retained.*

Accounts Receivable

18.71 The Department has recognized a number of problems in the Customs accounts receivable systems and has formulated new policies and procedures aimed at strengthening internal control over this area. At the time of writing this Report, we had not reviewed the implementation and actual operation of the new system. Our review of the new procedures indicated a limited number of internal control weaknesses that warrant further review and evaluation.

18.72 These weaknesses include a lack of integrated control over all types of receivables; inadequate segregation of duties, both in the maintenance of accounts receivable control in the various operating units and in the collection by the receivables personnel of amounts owing; and a lack of training on collection procedures for personnel in the various operating units that maintain their own accounts receivable. We understand that the Department plans to remedy these control deficiencies as a further part of implementing its new receivables system.

18.73 *The Department should further improve internal control over Customs accounts receivable by ensuring that all forms of receivables are covered by its revised procedures and by providing appropriate training for operational staff outside of the accounts receivable units who are involved in the collection of receivables.*

Collection

18.74 In many ports, we observed a lack of segregation of duties and of supervisory review of work performed, thus exposing the Department to the possibility of error and fraud. Collection reports are not sufficiently detailed to act as a secondary control over the collection operations or as a management decision-making tool, particularly with regard to the use of staff. In some cases we noted that government regulations, including those covering the receipt and deposit of public money, are not being followed.

18.75 The Department's sole data base for collection is the records room in each port. Access to them is not adequately controlled and therefore they do not provide secure storage of important records.

18.76 The above weaknesses in internal control restrict the Department's ability to control the receipt and deposit of public money and to provide accurate and complete records to support this activity.

18.77 *The Department should expand procedures and make them more explicit in the areas of segregation of duties, physical security of records and supervisory involvement in cashier functions; and ensure adherence to these procedures.*

18.78 *The Department should enforce adherence to regulations, including those covering the receipt and deposit of public money.*

Bonded Warehouses

18.79 Importers may, under certain circumstances, bring goods into Canada under bond and pay the applicable duties and taxes as the goods are used, rather than at the time of import. The Department has allowed the establishment of approximately 1,200 bonded warehouses operated by the private sector, which it inspects (audits) to enforce bonded warehouse regulations and to ensure eventual payment of the appropriate duty and tax.

18.80 Weaknesses in the system of numbering and registering of entries, poor record keeping and inadequate physical control over documents and ledgers may result in a loss of revenue.

18.81 In our review of the procedures for controlling bonded warehouses, we noted that the criteria for selecting warehouses for inspection, based on the bonded warehouse registration numbers, do not include such factors as inventory size and history of irregularities. There are also a number of weaknesses in the inspection procedures, including insufficient supervisory involvement in inspections and inadequate reporting of inspection findings. As a result, there is a risk of seriously weakening the inspection function's effectiveness as a deterrent against non-compliance by warehouse operators and in detecting accidental or deliberate errors. We understand that the Department is preparing procedures intended to standardize the penalty structure and bonded warehouse inspection procedures.

18.82 *The Department should provide for better accounting records for goods stored in bonded warehouses, as well as greater security and more regular and effective follow-up of open files.*

18.83 *Inspections of bonded warehouses should stress the importance of verifying physical inventory and ensure that warehouse operators' and Customs' records agree.*

18.84 *Provision should be made for greater involvement of supervisory personnel in the inspection function and for improved reporting of inspection findings. Also the criteria used in determining which bonded warehouses to audit should be re-examined.*

Assessment

18.85 Customs Inspectors and Commodity Specialists appraise import entry documents, with calculation checks provided by calculator operators. Commodity Specialists review the majority of entries over prescribed value limits. These account for the bulk of Customs' revenue. The review requires the exercise of judgment on the content of an extensive volume of complex documents. Although they have already been reviewed by Customs Inspectors, the physical attributes of the goods concerned may not always be clearly identified.

18.86 The lack of registration of documents under review and poor physical security over the working area, coupled with the destruction of documentation immediately following its review, prevent the Department from ensuring the completeness of the assessment process.

18.87 The use of arbitrarily established limits, under which entries will receive only cursory review, and the adjustment of these limits by certain regions based on their workload, may be having a detrimental effect on Customs' ability to assess and therefore ultimately collect all the revenue owing to the Government.

18.88 Supervision and management reporting are not acting as overriding controls over the output and quality of the assessment function. In addition, the lack of staffing arrangements based on regional volumes, and insufficient use of formal and regular training programs for all employees in the assessment function, detract from the Department's ability to ensure an appropriate quality of document review.

18.89 Given the difficulty of the task, strong controls are needed to assure the quality of the assessment function.

18.90 *The Department should analyse all cost-benefit implications before establishing value for duty limits below which entries will not receive regular review by the Commodity Specialist Unit.*

18.91 *The Department should strengthen control of the assessment function by retaining key documents for an appropriate period of time, establishing better supervisory procedures and ensuring that training and staffing levels are commensurate with its needs.*

Drawbacks, Refunds and Remissions

18.92 Under trade stimulus programs, the Department allows importers a recovery of duty paid (drawback), or forgives duties otherwise payable (remission). It also refunds duties and taxes that have been overpaid. In the last year, this activity processed repayments amounting to over \$260 million.

18.93 Our review of the remissions activity included only the regional Drawback, Refund and Remission units, excluding computer operations for machinery remissions, the Headquarters administration of remissions applications and the automotive free tariff program.

18.94 We endorse the improvements in internal control over the processing and accounting the Department is implementing for paying refunds. However, there are still areas where controls are weak. These include: a lack of standardized procedures for claim verification; insufficient supervisory review of source data supporting claims; no system of rotation for claim auditors to ensure independence; and poor physical security over claims being processed. Moreover, management reporting does not provide information on claims processed by type or importer. These weaknesses increase the risk of paying improper or duplicate claims.

18.95 In accordance with the Department's mandate to assess, collect and account for duties and taxes, various operational units have been assigned responsibility for ensuring that goods imported under remission orders are in fact entitled to forgiveness of duties and taxes. In addition, the Financial Administration Act requires the Department to report annually in the Public Accounts remissions that exceed \$1,000. However, there are weaknesses in the system -- in document control, audit verification (similar to those mentioned above), and reporting. These weaknesses could allow invalid or unauthorized remissions to go undetected. This, in turn, could lead to information and amounts reported in Public Accounts being understated or inaccurate. Departmental officers, with whom we discussed this matter, recognize the need to review the remission system, and indicated that such a review would be undertaken in 1980.

18.96 *The Department should amend its procedures to provide for adequate physical security over claims, improved supervision and reporting of refund activity and improved claims file documentation. It should develop selection criteria and audit profiles that can be used in selecting and examining claimants.*

18.97 *The Department should make sure that its plan to re-examine present controls over accounting and reporting of remissions includes a complete evaluation of all internal controls relating to this function.*

Investigations

18.98 By investigating suspected, alleged or known misrepresentations, evasions, or commissions of fraud by importers, exporters or their agents, the Investigations Unit seeks to detect those who have committed and deter those who would commit breaches of laws Customs and Excise administers.

18.99 Our audit included an evaluation of the system of internal control in the cases identified for investigation and the subsequent investigation, accounting for and collection of the underpayments involved. It also included the financial reporting system, investigative procedures and the independence, training and deployment of investigation staff.

18.100 We observed that many of the above were governed by inadequate criteria, standards and procedures, making it difficult for the Department to ensure that the quality and effectiveness of field investigations are commensurate with its needs. In addition, there were no clear directives to ensure that staff in other functions would refer information to the Investigations Unit in appropriate circumstances. We also observed that a significant number of cases were closed without investigations and without a determination of the impact on revenue collection that this action may have had.

18.101 *The Department should take action to strengthen control over the information referred to the Investigations Unit and the files the Unit maintains. It should also reevaluate staffing and training requirements and investigation procedures. In addition, more effort is required to ascertain the potential for revenue collection in cases referred to the Unit for possible investigation.*

Statistical Determination of Assessment Revenue Gap

18.102 We considered the quantification of revenue loss in at least one of the functions of declaration, assessment and collection to be an important element in examining issues of cost effectiveness, particularly for determining:

- whether practical means are available to measure the effectiveness of the assessment function;
- the extent to which alternative cost-effective methods may be available for maximizing revenue; and
- whether there is a revenue gap and, if so, its size and some indication of its causes.

18.103 Because the test was limited to assessment, the results should not be construed as indicative of the combined "revenue gap" that may exist in all functions. In view of the voluntary compliance aspect of Customs' operations, there is the possibility that as much or more chance of revenue loss exists in the declaration process as in assessment. Moreover, the test was designed to identify situations which

give rise to incorrect assessments, resulting in either under-collection or over-collection of revenue, and could not determine whether errors were accidental or deliberate.

18.104 The tests showed that in a six-month period, one major port had an estimated \$14 million (approximately three per cent) of additional revenue, which could have been identified by the assessment function. This is our best estimate of the assessment revenue gap for these six months, although it could lie within a range of \$5 million to \$22 million. The period our test covered in this port included the introductory phase of the Examination Release Appraisal System (ERA). We carried out similar tests in one other large port and two smaller ports. It should be noted that with respect to all ports tested the monetary expression of the collectible revenue gap at the point in the system tested is not necessarily equivalent to the amount of duty and tax which would be collected from importers. To ascertain this amount an entirely different type of test would be required.

18.105 We could not place confidence in the test results for the smaller ports, because departmental filing systems and accounting procedures precluded the extraction of the required sample of documents in the appropriate way. The results of the test on the remaining large port for a sample period of nine months showed an estimated gap of \$4 million (0.7%) within a range of \$1 million to \$6.5 million. During the nine months a partially computerized assessment system was operational. The ERA System was in place for the entire period. Because of a number of considerations about this port, we have suggested that the test be undertaken again, as the Department did for the port with the larger revenue gap, to ascertain why the results are at such variance with the other large port tested.

18.106 Our audit, with the assistance of departmental staff, demonstrated that practical means are available to quantify the effectiveness of the assessment function. Similar tests could be applied to measure the effectiveness of the Department's other operations, such as examination of goods, investigations, the post-audit carrier system and drawbacks and refunds. The results of our tests indicate (as could reasonably be expected in any large and complex voluntary compliance revenue system) that there is a difference, biased in favour of importers, between the duties and taxes which could appropriately be considered collectible and those which actually are assessed. Of greater importance, and particularly in view of the Department's resource constraints, these tests not only show the effectiveness of existing control mechanisms, but analysis of the results also suggests approaches to maximizing revenue collection or carrying out other activities on a cost-effective basis. This subject is also discussed in paragraphs 18.48 to 18.50 (Study of Procedures in Cost Effectiveness).

18.107 The results of these tests, in turn, could help determine the adequacy of present staffing levels and the true impact of increasing or decreasing staff on potential revenue collection and other enforcement activities. For example, we noted that in the port referred to in paragraph 18.104, 80% of the Department's revenue derived from the upper 20% of entries ranked in order of their value for duty; 90% of the assessment revenue gap we identified derived from the upper 15% of entries ranked by value for duty.

18.108 The results showed that setting the critical value for duty on entries to be reviewed by Commodity Specialists at a level higher than the existing one would reduce the volume for review substantially, while at the same time, likely result in just as high a revenue capture rate.

18.109 *The Department should undertake tests, based on statistical sampling techniques, to measure the effectiveness of the assessment function and should consider their use in the measurement of other functions.*

18.110 *Criteria used to determine which import declarations should be subject to detailed review by the Department should be carefully examined to determine whether they meet the Department's need for the most cost-effective use of its staff resources.*

Computerized Cargo Entry Processing and Collection System (CEPACS)

18.111 To cope more efficiently and effectively with the volume of transactions, the Department embarked on a major program of computerization, starting in 1970.

18.112 The CEPACS system which evolved was closely patterned after existing manual procedures and comprises two major segments. One segment creates and maintains a file representing cargo control documents for all imported goods entering the country. It relieves this file by comparing the information on the documents presented by importers and brokers with that on the corresponding import entry documentation, thereby helping to ensure that all goods are properly acquitted and duty paid. A second segment checks the accuracy of certain of the information on declarations by importers and brokers.

18.113 In 1977, we examined the development of the CEPACS system as part of a government-wide review of the controls over electronic data processing systems (the CAISE Study). This review covered the adequacy of the organizational controls and the management and planning controls in the development of the CEPACS system from its inception to the time of the CAISE Study.

The CAISE Study observed that:

- A major computer systems development had been undertaken without the necessary capability and resources for such a large project. Throughout the developmental stages of the project, there were indications of serious weaknesses in planning, budgeting and general management control practices.
- The system was not fully implemented and there was still a significant number of important questions pertaining to the basic feasibility of the system and its cost-effectiveness.

18.114 During the last year, the Department made a number of important changes aimed at upgrading management controls over development of this system. At the time of our 1978 audit of revenue systems, CEPACS had become operational in the pilot region and the Department was considering further implementation in other regions. Because of the impact of CEPACS on control over revenue and the findings of the CAISE Study in systems development, we felt it appropriate to examine the financial controls in the system and to review the planning controls over its further implementation.

18.115 Our review of controls in effect at the time of our audit indicated that in a number of situations controls had been established in such a way as to give only minimal protection against fraud and certain types of errors.

18.116 As to further implementation, we noted that the Department was aware of a number of significant problems surrounding the operation of this system. Owing to these problems and the magnitude of the system, the Department established a number of criteria to guide its decision making on further implementation. These criteria included the system's effectiveness in accurate revenue

assessment, its ability to meet user turnaround needs, its compatibility with manual systems, adequacy of the existing configuration and capability for accepting new functions.

18.117 During the last year, the Department conducted a number of reviews and prepared various analyses to address the questions and issues posed by the criteria.

18.118 Our review of the methodology chosen to examine CEPACS' impact on revenue led us to believe that insufficient work has been done to justify further expansion, based on its ability to improve revenue assessment and collection. Departmental reports acknowledged that on the basis of the work done, the increases in revenue in the one region where the system was operational could not be specifically identified with CEPACS. We believe that greater emphasis should be placed on testing designed to compare the processing of specific actual transactions through CEPACS with the processing of these same documents through manual systems.

18.119 As to the other non-revenue criteria established by the Department, we noted that reports in a number of cases recognized that performance criteria will have to be established and sufficient underlying factual data accumulated to undertake suitable evaluation of CEPACS. These criteria should include standards for speed, accuracy and cost-effectiveness of CEPACS processes. The Department has recognized that, in other regions, certain features of manual systems (which do not conform to established Customs regulations) will have to be amended to help ensure the orderly and efficient introduction of CEPACS.

18.120 We believe that the resolution of these matters calls for broad fundamental decisions which will affect much more than just the CEPACS system and which may have an impact on a number of present practices.

18.121 In summary, the departmental reports on CEPACS we reviewed raise many important issues and questions, the answers to which will have a major influence on further implementation decisions.

18.122 The Department recently decided to implement and carefully monitor the system in another location. We understand that this decision was based on judgment of circumstances and that whatever risks the decision entailed were clearly recognized and considered reasonable by the Department. The Department is conducting further studies on the effectiveness of CEPACS in the revenue area.

18.123 *The Department should defer further implementation of the CEPACS system until cost-benefit analyses have been completed and the underlying issues and questions, raised in departmental reports evaluating CEPACS, have been fully answered.*

18.124 *Where CEPACS is already installed, action should be taken to assess the impact of existing control deficiencies and to take appropriate remedial action.*

Internal Audit

18.125 The Department maintains an internal audit function with an authorized staff complement of 65 man-years and a budget exceeding \$1.6 million. In 1974-75 we reviewed this function to determine whether any major deficiencies existed which would diminish the potential effectiveness of Internal Audit as a key component of the Department's general system of financial management and control. At that time certain recommendations were made for improvement.

18.126 As part of our recently completed audit of controls in the Customs' revenue system, we again reviewed the internal audit function to determine the extent to which the Department had adopted and implemented the recommendations of the Financial Management Control Study (FMCS) in 1974-75. Our review also sought to determine whether the internal audit function, as organized, planned, staffed and carried out, played an effective part in the managerial control system, commensurate with our evaluation of the Department's needs in this area.

18.127 It is evident that functional and line managers carry the burden of developing and operating the Department's control systems. Internal Audit has a significant role to play: first, by designing and executing an audit program that will identify areas where controls are not geared to the degree of risk in the process and where exposure to error, fraud or abuse has been increased because of poorly developed or improperly applied control mechanisms; and secondly, by carrying out audits that include full consideration of the effectiveness, efficiency and economy of departmental programs and procedures.

18.128 In attempting to provide a suitable framework within which Internal Audit can fulfil the demands of its role, senior management has taken a number of initiatives. These include the establishment of suitable terms of reference, a consolidated organization, clear lines of reporting and a review process through an Audit Committee. The major benefits of these recent changes will be felt over the longer term.

18.129 During our audit the Internal Audit Branch was defining revised programs that place greater emphasis on Customs activities. However, we understand that during the last year it has placed greater emphasis on Excise activities. These represent positive steps in upgrading the Department's internal audit function. In our opinion, however, Internal Audit has not thus far given the Department the required support primarily because it has not conducted a sufficient number of audits which recognize the degree of risk and exposure inherent in the nature of operations and because the necessary audit techniques and procedures have not yet been fully developed. The findings of our study of internal auditing in this Department should be viewed against our study of internal auditing in a government-wide context. The latter is set out in Chapter 12.

18.130 Our review of internal audit in the Department revealed the following:

- Traditionally audits have been primarily concerned with compliance and placed insufficient emphasis on providing a proper evaluation of the quality of control mechanisms in major revenue related activities. Only recently has Internal Audit started a planning process intended to culminate in audit reports capable of providing a proper overview of the various major components of Customs activities.
- Internal Audit has formulated a number of plans and estimates of required resources. These plans provide for audits intended to achieve the objectives set out in the new audit mandate. However, in certain important areas these plans are not yet sufficiently detailed to allow for the suitable identification of staffing needs and time required.
- There have been significant delays in providing audit reports to the Deputy Minister, although the contents of these reports have been provided to those responsible for the particular function or region or both.
- Systems-based audit techniques have only been partially applied and other techniques that would help ensure efficient and effective audits have not been used.

- There has been a lack of supervision necessary to help ensure the adequacy of detailed planning, execution and reporting of audits.

18.131 Our review of internal audit has led us to the opinion that our Office will continue to be in a position where it can only place limited reliance on the Department's internal audit work until significant improvements, some currently under way, have been effectively implemented in the manner Internal Audit is planned, staffed, carried out and reported. This degree of reliance will not be sufficient to affect materially the nature, timing and extent of audit work by this Office on Customs activities.

18.132 The new audit mandate and the Audit Committee will help clarify roles and relationships and provide ongoing monitoring and general emphasis to the function. However, the root deficiencies which have affected Internal Audit point to a more fundamental problem in determining the ways in which audits might be designed and staffed to achieve objectives. Present plans to upgrade Internal Audit to achieve its new audit mandate will create a major challenge to achieve success in both the short and long-term.

18.133 *The Department should place greater emphasis on:*

- *clearly identifying the nature of audits required and their constituent components;*
- *establishing priorities and time frames to achieve the audit objectives contained in the departmental audit policy;*
- *assessing staff skills against new and existing audit plans and necessary audit techniques and obtaining appropriate resources if required; and*
- *adopting the most suitable audit techniques or refining existing ones.*

Summary of Recommendations and Department's Comments

STUDY OF PROCEDURES IN COST EFFECTIVENESS

Measurement of Program Effectiveness

Recommendation

18.50 The Department should develop effectiveness indicators for the "Examination and Control of Commercial Operations" sub-activity so that its contribution to program objectives can be measured.

Department's Comment

Agreed. The Department is continuing to evaluate its operations for the purpose of establishing satisfactory procedures to measure and report on effectiveness.

Measurement of Operational Performance

Recommendation

18.56 As part of the Department's Agreed. current efforts to develop a revised approach to performance measurement, it should place greater emphasis on clearly defining appropriate outputs and establishing work standards at a number of key work locations which will contribute to the development of a set of national standards and to the improvement of management reports.

Department's Comment

Agreed.

CONTROLS IN THE CUSTOMS REVENUE SYSTEM

Controls over Examination and Inland Movement of Goods

Recommendation

18.63 The Department should:

- evaluate alternative approaches to conducting the examination selection process to determine the most appropriate method of measuring non-compliance. Such approaches could be based on a combination of statistically valid sampling techniques, profiles and intelligence information;

Department's Comment

Agreed. High priority has been given to this in departmental plans.

Recommendation

- develop an improved system of documenting the results of the examination process and ensure that it is implemented consistently on a national basis. This information should form the basis for improved communication between the Customs Inspector and the Commodity Specialist;

Department's Comment

The Department agrees that even greater emphasis be given to ensuring that policies are consistently applied on a national basis.

Recommendation

- re-evaluate the post-audit carrier system to determine whether it achieves acceptable levels of effectiveness in detecting and deterring error or fraud; and

Department's Comment

Agreed.

Recommendation

- establish selective tests to determine the impact of weaknesses in the declaration process and the most cost - effective method of implementing controls.

Department's Comment

The Department will continue to review the declaration process periodically and make such changes as are justified by cost-benefit analysis.

Cargo Control Documentation

Recommendation

18.69 The Department should assess the impact of existing control weaknesses on revenue collection and re-evaluate the control needs in this area, with emphasis on document control, supervision, reconciliation and reporting.

Department's Comment

The Department will continue to review Revenue Collection procedures periodically and make such changes as are justified by cost-benefit analysis. Re-evaluation of the control needs with emphasis on document control, supervision, reconciliation and reporting will be part of the next review.

Recommendation

18.70 The Department should provide better physical safeguards over open cargo control document files and provide that key documents be retained.

Department's Comment

The departmental document control policy will be reviewed and strengthened where necessary. It is also agreed that an effective audit trail should be maintained.

Accounts Receivable

Recommendation

18.73 The Department should further improve internal control over Customs accounts receivable by ensuring that all forms of receivables are covered by its revised procedures and by providing appropriate training for operational staff outside of the accounts receivable units who are involved in the collection of receivables.

Department's Comment

The Department agrees that its procedures will apply to all types of receivables and that appropriate training will be provided for operational staff involved in the collection of receivables.

Collection

Recommendation

18.77 The Department should expand procedures and make them more explicit in the areas of segregation of duties, physical security of records and supervisory involvement in cashier functions; and ensure adherence to these procedures.

Department's Comment

The Department is reviewing existing procedures governing segregation of duties, physical security of records and supervision involvement in cashier functions and will amend them where appropriate.

Recommendation

18.78 The Department should enforce adherence to regulations, including those covering the receipt and deposit of public money.

Department's Comment

Compliance with regulations is currently enforced by communicating the policies and procedures in manuals and bulletins, doing systems reviews, operating compliance check systems and internal and external audit reviews. The effectiveness of these processes will be reviewed.

Bonded Warehouses

Recommendation

18.82 The Department should provide for better accounting records for goods stored in bonded warehouses, as well as greater security and more regular and effective follow-up of open files.

Department's Comment

Agreed. A study is currently underway.

Recommendation

18.83 Inspections of bonded warehouses should stress the importance of verifying physical inventory and ensure that warehouse operators' and Customs' records agree.

Department's Comment

Agreed.

Recommendation

18.84 Provision should be made for greater involvement of supervisory personnel in the inspection function and for improved reporting of inspection findings. Also the criteria used in determining which bonded warehouses to audit should be reexamined.

Department's Comment

Agreed. This will be considered as part of the study mentioned in paragraph 18.82 above.

Assessment

Recommendation

18.90 The Department should analyse all cost-benefit implications before establishing value for duty limits below which entries will not receive regular review by the Commodity Specialist Unit.

Department's Comment

Agree.

Recommendation

18.91 The Department should strengthen control of the assessment function by retaining key documents for an appropriate period of time, establishing better supervisory procedures and ensuring that training and staffing levels are commensurate with its needs.

Department's Comment

The Department will continue to review the assessment functions periodically and make such changes as are justified by cost-benefit analysis.

Drawbacks, Refunds and Remissions

Recommendation

18.96 The Department should amend its procedures to provide for adequate physical security over claims, improved supervision and reporting of refund activity, and improved claims file documentation. It should develop selection criteria and audit profiles that can be used in selecting and examining claimants.

Department's Comment

The Department will continue to review claims procedures periodically and make such changes as are justified by cost-benefit analysis. The Department agrees to develop selection criteria and audit profiles taking into consideration the observations raised by the Auditor General.

Recommendation

18.97 The Department should make sure that its plan to re-examine present controls over accounting and reporting of remissions includes a complete evaluation of all internal controls relating to this function.

Department's Comment

Agreed.

Investigations

Recommendation

18.101 The Department should take action to strengthen control over the information referred to the Investigations Unit and the files the Unit maintains. It should also re-evaluate staffing and training requirements and investigation procedures. In addition, more effort is required to ascertain the potential for revenue collection in cases referred to the Unit for possible investigation.

Department's Comment

The Department will continue to review its investigation policies and procedures and make such changes as are justified by cost-benefit analysis.

Statistical Determination of Assessment Revenue Gap

Recommendation

18.109 The Department should undertake tests, based on statistical sampling techniques, to measure the effectiveness of the assessment function and should consider their use in the measurement of other functions.

Department's Comment

It is agreed that effectiveness measurement systems must be strengthened for all functions including assessment.

Recommendation

18.110 Criteria used to determine which import declarations should be subject to detailed review by the Department should be carefully examined to determine whether they meet the Department's need for the most cost-effective use of its staff resources.

Department's Comment

The Department will continue to review these criteria periodically and make such changes as are justified by cost-benefit analysis.

Computerized Cargo Entry Processing and Collection System (CEPACS)

Recommendations

18.123 The Department should defer further implementation of the CEPACS system until cost benefit analyses have been completed and the underlying issues and questions, raised in departmental reports evaluating CEPACS, have been fully answered.

Department's Comment

Agreed. The Department has already taken this action.

Recommendation

18.124 Where CEPACS is already installed, action should be taken to assess the impact of existing control deficiencies and to take appropriate remedial action.

Department's Comment

Agreed. The Department will continue to improve the CEPACS system and to correct whatever deficiencies are identified.

Internal Audit

Recommendations

18.133 The Department should place greater emphasis on:

- clearly identifying the nature of audits required and their constituent components;
- establishing priorities and time frames to achieve the audit objectives contained in the departmental audit policy;
- assessing staff skills against new and existing audit plans and necessary audit techniques and obtaining appropriate resources if required; and
- adopting the most suitable audit techniques or refining existing ones.

Department's Comment

Agreed. Emphasis will continue to be placed on these areas and refinements and/or adjustments in line with the intent of the recommendations will be made as necessary.

1978 Report of the Auditor General of Canada - Chapter 19

```
<BODY BGCOLOR="#FFFFFF">
<CENTER>
<H1>Department of Transport</H1>
</CENTER>
<IMG SRC="../../graphics/linegra3.gif" WIDTH=100% ALT="line">
<HR>
```

Summary of Findings, Observations and Recommendations

Introduction

19.1 This Chapter reports the results of our audit work within the Department of Transport and related agencies and Crown corporations during the 1977-1978 fiscal year. It includes a brief background of the Department's operations and a summary of our audit activities and observations. In addition to our regular audit activities we conducted several special studies as part of our examination of the Department during the year, and have devoted a separate segment of the Chapter to each of them.

Departmental Overview

19.2 The Department of Transport is responsible for the administration of the Federal Government's transportation policies and programs. It is one of the larger and more complex government departments, accounting for 20,929 man-years and total expenditures of \$1,017 million excluding payments to related agencies and Crown corporations in the fiscal year ended March 31, 1978. The total cost of assets under its administration exceeds \$3,000 million.

19.3 The basic objective of the Department, as stated in the proposed amendment to the National Transportation Act, *R.S., c. N-17*, is to administer a transportation policy that gives Canada an efficient transportation system that is an effective instrument of support for achieving national and regional social and economic objectives and provides accessibility and equity of treatment for users.

19.4 The Department consists of a Headquarters and three Administrations - Air, Marine and Surface. These are further sub-divided into some 2,000 responsibility and cost centres which are responsible for over 110 separate and distinct program sub-activities. In addition, the Department is responsible for the Airports Revolving Fund which is treated as a separate entity for financial reporting purposes.

19.5 In addition, the Minister of Transport is responsible for the following related agencies and Crown corporations, all of which contribute directly to the achievement of the Department's objectives.

Canadian Transport Commission

National Harbours Board

St. Lawrence Seaway Authority

Seaway International Bridge Co., Ltd.

Atlantic Pilotage Authority

Great Lakes Pilotage Authority

Laurentian Pilotage Authority

Pacific Pilotage Authority

Northern Transportation Company Limited

Air Canada

Canadian National Railways

Canadian National (West Indies) Steamships, Ltd.

Via Rail Canada Inc.

19.6 The nature of these agencies and Crown corporations is discussed later in this Report. Although each organization is essential to achieving the objectives of the Department, their impact on the Department of Transport section of the Public Accounts is limited to specific parliamentary appropriations which fund certain limited aspects of their programs or operations. Separate financial statements are prepared for each of these entities. The problems resulting from this practice are discussed in Chapter 6 of our Report.

19.7 The total expenditures of the Department, including payments to related Crown corporations, agencies and the Airports Revolving Fund can be summarized as follows:

<u>Budgetary</u>	<u>1977-78</u>	<u>1976-77</u>
	(thousands of dollars)	
Operating	\$ 846,203	\$ 733,749
Capital	231,525	229,228
Grants and Contributions	<u>546,416</u>	<u>492,391</u>
	1,624,144	1,455,368
Less: Receipts and revenues credited to the Vote	<u>153,362</u>	<u>142,322</u>
	1,470,782	1,313,046
<u>Non-Budgetary</u>		
Loans and advances	<u>172,217</u>	<u>145,445</u>
Total	<u>\$ 1,642,999</u>	<u>\$ 1,458,491</u>

Operatic Expenditures

19.8 **Headquarters Administration.** Headquarters Administration includes the offices of the Minister and Deputy Minister and provides for central functions including planning, policy formulation, research and development. The Headquarters consisted of 1,233 employees at March 31, 1978, and its total operating expenditures were \$48.0 million for 1977-78 and \$44.3 million for 1976-77.

19.9 **Air Administration.** The Canadian Air Transportation Administration (CATA), responsible for the construction, operation and maintenance of civil airports and seaplane docking facilities owned or controlled by the Department, is the largest of the Department's Administrations. It also operates and maintains telecommunications and electronic navigation facilities; provides an air traffic control system for Canada and designated international airspace; develops and enforces aeronautic legislation standards and procedures for the inspection, examination and licensing of aviation personnel, commercial operators and aircraft and for investigating aircraft accidents; and operates and maintains a fleet of 55 aircraft for use in calibrating navigational aids and transporting government officials.

19.10 CATA consists of a Headquarters staff and six regional offices as shown below:

<u>Region</u>	<u>Location</u>	<u>Number of Employees</u>	<u>Gross Operating Expenditures</u>	
			1977-78	1976-77
			(thousands of dollars)	
Headquarters	Ottawa	1,744	\$ 71,896	\$ 77,278
Atlantic	Moncton	2,246	61,921	59,626
Western	Edmonton	1,662	48,095	41,945
Quebec	Montreal	1,552	44,851	41,460
Ontario	Toronto	1,625	43,486	37,234
Central	Winnipeg	1,349	42,703	37,200
Pacific	Vancouver	<u>1,342</u>	<u>36,151</u>	<u>31,375</u>
		<u>11,520</u>	<u>\$ 349,103</u>	<u>\$ 326,118</u>

Within the regions, the Federal Government owns 168 domestic airports of which 90 are operated by CATA (including Malton, Dorval, Mirabel and Vancouver which are part of the Airports Revolving Fund).

19.11 **Marine Administration.** The Canadian Marine Transportation Administration (CMTA) co-ordinates a number of bodies engaged in marine activities including the National Harbours Board, the St. Lawrence Seaway Authority and the Pilotage Authorities. The principal element of CMTA is the Canadian Coast Guard (CCG), which is responsible for navigational aids, ship safety and regulations,

telecommunications and electronic services and other marine support services its fleet provides. These services include icebreaking and ice escort, search and rescue, fishing zone patrol and maritime pollution control. CMTA also administers designated public harbours and other federal marine properties and legislation pertaining to local harbour commissions.

19.12 The Canadian Coast Guard consists of a Headquarters staff and five regional offices as shown below:

<u>Region</u>	<u>Location</u>	<u>Number of Employees</u>	<u>Gross Operating Expenditures</u>	
			1977-78	1976-77
			(thousands of dollars)	
Headquarters	Ottawa	752	\$ 60,611	\$ 53,898
Maritimes	Dartmouth	1,296	40,058	36,705
Laurentian	Quebec	1,028	36,949	32,869
Western	Vancouver	707	22,803	21,163
Central	Toronto	494	15,637	14,524
Newfoundland	St. John's	<u>442</u>	<u>13,435</u>	<u>11,434</u>
		<u>4,719</u>	<u>\$189,493</u>	<u>\$170,593</u>

Within the above regions there are 11 district offices, 400 wharfingers and harbour-masters and over 150 ships, including several large icebreakers.

19.13 **Surface Administration.** The Canadian Surface Transportation Administration (CSTA) is responsible for administering federal policies relating to railways, motor vehicle safety, highway and ferry services. It is also responsible for the operation of certain maritime ferry services, assumed by Canada either at the time of Confederation or under the Terms of Union with Newfoundland. CN Marine operates these ferry services for the Department. CSTA had 251 employees at March 31, 1978, and operating and maintenance expenditures of \$139.6 million in 1977-1978 and \$99.5 million in 1976-1977, including ferry operating deficit payments.

Capital Expenditures

19.14 The Department is heavily involved in acquiring and constructing various facilities and equipment. Capital expenditures during the year totalled \$231.5 million, representing approximately 14% of the total capital spending within the Federal Government. Many of the items involve substantial amounts of funding over a number of years and are handled on a project basis. Major projects which were in process during the year under review are as follows:

<u>Project</u>	<u>Total Estimated Cost</u>	<u>Current Expenditure</u>	<u>Future Requirements</u>
	(millions of dollars)		
Air Navigation Services-JETS	\$ 26.7	\$ 3.9	\$ 6.4
Calgary International Airport	127.4	26.9	-
Edmonton International Airport Addition	32.7	2.2	10.9
Pickering Airport Project	112.0	12.5	16.9
Integrated Communication Control Equipment	14.2	4.2	1.7
Toronto (Malton) International Airport Additions	159.7	35.3	54.8
Vancouver International Airport Addition	33.5	4.3	6.9
Lightstation Automation	14.2	1.0	.1
"R" Class Icebreakers	108.0	39.8	34.8
West Coast Vessel Traffic Management System	18.0	4.9	6.3
Motor Vehicle Test Centre	25.8	8.2	1.0
Newfoundland Passenger Vessels 1 and 2	85.5	-	83.6
Port aux Basques Terminal	22.7	4.2	12.3
Replacement for Motor Vessel Abegweit	35.5	0.2	34.4
Transport Canada Training Institute	58.0	21.8	14.5

Grants and Contributions

19.15 The Department makes substantial contributions or transfer payments to the provinces, municipalities and certain research organizations to improve transportation facilities in Canada.

Contributions are used to improve and extend major highway and rail facilities and to support coastal passenger and ferry services.

19.16 Major contributions are shown below:

	<u>1977-78</u>	<u>1976-77</u>
	(thousands of dollars)	
<u>Contributions</u>		
The capital costs of rehabilitating Prairie Branch Railway Lines	\$ 30,000	\$ -
Upgrading primary highway networks in Alberta, Saskatchewan and Manitoba	28,447	26,702
The construction and operation of certain railway lines in British Columbia	27,000	54,000
Water transportation subventions for ferry and coastal passenger and freight services	13,494	15,564
Extending the network of highways and road facilities in the northern areas of British Columbia, Alberta, Saskatchewan and Manitoba	11,033	10,736
Payments to Alberta in respect of the maintenance of domestic oil prices	14,000	20,000
Provision of ferry and coastal freight and passenger services in British Columbia	8,000	-

Summary of Audit Activities

19.17 A major emphasis in our examination of the Department concerned the Office's responsibility for expressing an opinion on the financial statements of the Government of Canada for the fiscal year ended March 31, 1978. Transport was selected as one of a number of departments for an in-depth examination as part of a rotating emphasis from year to year.

19.18 Our examination within the Department considered the various program activities, the significance of expenditures, the individual parliamentary appropriations, the decentralized nature of the operations as well as the scope and results of audits performed in prior years. In performing our work, we reviewed the various accounting procedures and internal control measures at selected locations as a basis for determining the extent of our examination and number of items to be tested. In addition, the

work of the Financial Audit and Review Branch was reviewed as another element of the internal control system within the Department.

19.19 We placed considerable emphasis on testing and evaluating the Department's accounting procedures and internal control measures, since the extent of activities and volume of transactions make it impracticable to perform a detailed audit of all of the Department's transactions. Our examination also sought to determine whether the Department has complied with the various legislative requirements, including Treasury Board policies and guidelines.

19.20 Our selection of individual transactions for examination was facilitated by extracting specific data from the Department's EDP records with an audit extract program. This technique allows a relatively easy identification and segregation of "risk" items, based on both dollar amounts and nature of expenditure, for in-depth substantive testing.

19.21 During the year, in addition to the work performed at the various Headquarters locations, the following locations were visited:

Air Administration	Marine Administration
<p>Regional Offices</p> <p>Atlantic - Moncton</p> <p>Central - Winnipeg</p> <p>Ontario - Toronto</p> <p>Pacific - Vancouver</p> <p>Quebec - Montreal</p> <p>Western - Edmonton</p>	<p>Coast Guard Regional Offices</p> <p>Central - Toronto</p> <p>Laurentian - Quebec</p> <p>Maritime - Dartmouth</p> <p>Newfoundland - St. John's</p> <p>Western - Vancouver</p>
<p>Other locations</p> <p>Calgary Airport</p> <p>Goose Bay Airport</p> <p>London Airport</p>	<p>Coast Guard Bases</p> <p>Quebec</p> <p>Parry Sound</p>

19.22 In addition to financial and compliance audit work, we conducted a number of special studies within the Department in connection with our expanded mandate and certain government-wide studies of specific areas. These special studies included:

- an evaluation of the internal audit function;
- an evaluation of the planning and acquisition of capital assets as it relates to seven major projects;

- an evaluation of controls over fixed assets; and
- an evaluation of human resource management.

Results of Financial Audit

19.23 As indicated in the summary of audit activities, extensive audit work was performed within the Department of Transport to assist the Office in forming an opinion on the financial statements of the Government of Canada. During our examination we noted a number of weaknesses in accounting procedures and internal controls. These observations and our recommendations were formally reported to the Department in management letters. Most of these observations and recommendations were not significant enough to warrant inclusion in this Report. Those that are, are discussed in the paragraphs that follow.

19.24 **Inadequate guidelines for determining ferry deficits.** Previous Reports (paragraph 18.10 in 1977) drew attention to the lack of a formal agreement covering the terms and conditions for the operation of the Newfoundland coastal service, the Prince Edward Island ferry service and the North Sydney/Port-aux-Basques ferry service. These services are operated for the Department of Transport by the Canadian National Railways (CNR). The Department has underwritten deficits calculated annually by CNR but, in the absence of a formal agreement, has been unable to verify the deficits charged to its appropriation each year. These deficits amounted to \$112.0 million for the 15 months ended March 31, 1978, and \$85.8 million for the 12 months ended December 31, 1976.

19.25 The Canadian National Marine Corporation (CNMC), a subsidiary of the CNR, has been formed to operate the services but no agreements have been signed establishing the terms and conditions for doing so.

19.26 *The Department should expedite the completion of a comprehensive operating agreement establishing the terms and conditions under which Canadian National Marine Corporation will operate the specified ferry services.*

19.27 **Unauthorized contracting of translation services.** Under the Translation Bureau Act, R.S., c. T-13, the Translation Bureau of the Secretary of State Department provides translation services to individual government departments free of charge. Where the Translation Bureau is unable to provide the translation service required by a Department, the Bureau contracts for the specific translation service required.

19.28 In our examination of certain projects it was noted that the Department of Transport had let a number of contracts at an estimated cost of \$107,000 with private firms for translating a number of technical manuals for use by various operating branches. The Translation Bureau was not asked to have these manuals translated since the Department was of the opinion that the Bureau did not have the necessary expertise to do so within a reasonable time. Conversely, no authorization had been issued by the Translation Bureau authorizing the Department to contract for translation services.

19.29 *Departmental procedures should be established to ensure that all translation requirements are referred to the Translation Bureau.*

19.30 **Payment for services not received.** The Department of Transport chartered a new type of vessel and crew to evaluate its performance in icebreaking and rescue services. Early in the five-month charter, the vessel was damaged due to ice conditions and dry-docked for a period of 45 days. The

charter agreement called for either an alternative vessel acceptable to the Department or the termination of the contract if the original vessel was removed from service. Neither option was exercised. Reasons cited for continuing the charter were an inaccurate estimate of the length of the repair time and a desire to complete the evaluation during the current ice season.

19.31 The Department's failure to terminate the charter agreement resulted in unnecessary payments of \$100,000, while the vessel was unserviceable in dry-dock. Negotiations are now under way in an attempt to recover a portion of the charter fees paid while the ship was out of service.

19.32 *The Department should take steps to ensure that payments for services not received are avoided in the future.*

19.33 *Failure to follow up budgetary variances.* Responsibility centre managers at all levels receive monthly reports comparing performance for the year to date to budgeted amounts. Our review disclosed several instances where managers were not analysing these variances to determine their causes so that corrective action could be taken where applicable.

19.34 *Significant monthly variances should be analysed and the reasons documented. This documentation should contain plans for corrective action where necessary and notification as to the need for or availability of funds.*

19.35 **Failure to observe payment authorization regulations.** The Financial Administration Act and related regulations detail the approvals required on each payment requisition; e.g., certification as to goods supplied, services rendered, availability of funds, etc.. Where delegation of the above authority is allowed, this delegation must be documented on a signature card signed by the person to whom the authority is delegated and authenticated with the signature of a responsible officer. These procedures are key elements of the internal control system developed to maintain the integrity of inputs gathered from a highly decentralized operating system. We noted numerous instances where payment requisitions were signed by individuals who lacked documented authority to do so and others where the required signature was lacking altogether.

19.36 *The Department should take steps to ensure that only authorized individuals are allowed to certify requests for payment and that all required approvals are obtained before payment.*

Internal Audit

Introduction

19.37 The Department of Transport spent approximately \$1.5 million on internal audit coverage in 1977-78 representing a total of approximately 50 man-years excluding seconded non-audit staff who performed certain operations reviews.

19.38 Our general approach to reviewing the internal audit function was to examine sufficient material on organizational and reporting relationships, use of resources, planning of the audit function, audit practices and reporting, and audit follow-up to determine the effectiveness of the function.

19.39 The internal audit groups considered within the scope of our review included the Financial Audit and Review Branch, the three Operations Review Groups and the Evaluation Branch. Due to the breadth of pre-audit and post-audit functions within the Department we excluded from our review the

functional review groups (e.g., personnel review, telecommunications, quality assurance), the Cost Reduction Task Force and the Contract Review Board.

Audit and Operations Review Committee

19.40 The Audit and Operations Review Committee was established in 1976, when the Deputy Minister outlined the responsibilities of the Committee. The Senior Assistant Deputy Minister chairs the Committee and reports to the Transport Management Committee of which the Deputy Minister is the Chairman.

19.41 The Audit and Operations Review Committee comprises eight members: the Senior Assistant Deputy Minister, the three Administrators, the Assistant Deputy Minister, Finance, the Director General of Programming and Evaluation, the Director of the Financial Audit and Review Branch and the Director of the Evaluation Branch.

19.42 Up to March 31, 1978, the Chairman had called only three meetings, usually once a year, to consider the reports of the Auditor General and to coordinate internal financial audit and operations review activities. Subsequent to our review, the Deputy Minister announced his intention to chair the Committee, hold monthly meetings and expand the Committee's terms of reference. In addition, it is intended that the Assistant Deputy Minister, Finance of the Department of National Defence will be added to the Committee to provide constructive advice and challenge from outside the Department of Transport organization.

19.43 The Committee will be further strengthened by having it review and recommend policy directives, procedural guidelines and methodologies for audit and review processes. These and other proposed changes in the terms of reference and the composition of the Audit Committee should result in a much more effective Committee.

Financial Audit and Review Branch

19.44 The Financial Audit and Review Branch was established in 1966 after the Treasury Board Guide on Financial Administration was issued. The Branch performed approximately 125 audits at 50 separate locations during the year ended March 31, 1978. These audits were conducted by a staff of approximately 23 at a cost of approximately \$600,000.

19.45 Our review of the Financial Audit and Review Branch consisted of interviews, a review of its organization and an examination of working papers and reports.

19.46 **Reporting.** The Financial Audit and Review Branch reports to the Assistant Deputy Minister, Finance who reports directly to the Deputy Minister. This could result in a lack of independence and objectivity in carrying out the internal audit function.

19.47 *The Financial Audit and Review Branch should report to an individual independent of the financial function, who reports directly to the Deputy Minister and is responsible for co-ordinating all internal audit functions.*

19.48 **Audit plan.** At present the Branch prepares an annual audit plan outlining the locations to be visited and the elements of financial control to be reviewed. Our review of these plans and the planning process has revealed several weaknesses, including the following:

- The audit plan was not approved by senior management or the audit committee.
- The audit universe was not adequately defined and documented.
- The audit plan does not consider or evaluate risk factors such as known internal control weaknesses, etc.
- Audit priorities did not give adequate consideration to costs versus benefits expected to be obtained, especially in the area of concession type audits.
- The audit plan is based on authorized man-years within the Branch rather than the man-years which will be available.
- Little or no attention was paid to grants and contributions, and capital expenditures which together amount to 50% of the total departmental expenditures.
- No assessment was made of the impact of electronic data processing systems in determining the plans of the Branch.

19.49 *The Branch should develop a multi-year audit plan based on a clearly defined audit universe and taking into account high-risk elements, expected staff resources, a rotation of coverage and an analysis of costs versus benefits. The audit plan should be reviewed and approved by the audit committee.*

19.50 **Audit manual.** The "Financial Audit and Review Branch Audit Manual" sets out the policies to be followed by the audit staff. Responding to the Financial Management and Control Study's May 1975 recommendation that the Branch complete its audit manual as soon as possible, the Department stated in August 1975 that a revised manual had been issued. However, several important sections still have not been completed, including auditing standards, audit programs and procedures. Without auditing standards, audits cannot be adequately or consistently planned or performed.

19.51 *The Branch should establish a firm timetable for completing the manual and should ensure that the manual is completed in accordance with this schedule.*

19.52 **Working paper preparation.** Our review of a sample of audit working papers revealed serious documentation weaknesses including:

- Assignment sheets contained inadequate documentation of the scope of work to be performed.
- Work programs were not used consistently and when used were not approved before starting the work.
- Documentation of reasons for performing work, the basis for scope selection and sample selection methods was not set out in the working papers.

19.53 Because of the weaknesses outlined above, we were unable to determine whether the work performed was adequate. The adequacy of the audits cannot be properly assessed unless objectives are stated in advance, auditing standards are applied, control strengths and weaknesses identified, the scope adopted justified, the work completed in accordance with a prepared and approved program, conclusions reached and supervisory reviews performed.

19.54 *The Branch should develop and implement standards and procedures covering all aspects of working paper documentation including the scope adopted, work performed, conclusions reached and supervisory reviews completed.*

19.55 *Before starting field work, detailed work programs should be prepared and approved. These programs should document the basis for selecting audit samples, the size of samples to be obtained and the method of selection.*

19.56 **Conclusion.** As a result of the above observations, we have concluded that significant improvements are required in the Financial Audit and Review Branch's operations to increase the effectiveness to a satisfactory level. Although the Financial Audit and Review Branch carried out much audit work the scope and quality does not allow the Office of the Auditor General to materially alter the nature, timing or extent of its audit work.

Operations Review

19.57 Operations reviews were initially introduced in the Department in 1968. Three operations review branches operate within the Department:

- Operations Review - Air (established 1971);
- Operations Review - Marine (established 1977); and
- Operations Review - Headquarters and Surface (established 1977).

19.58 Our work in connection with the operations review branches was limited to discussions and a reading of reports and therefore did not constitute an audit as no detailed review of the work performed by the branches was conducted. We did not carry out a complete audit of operations review, because two of the three branches involved are in the developmental stage having completed only one review each.

19.59 **Mandate and planning.** Senior management indicated its support for operations audit in a mandate issued in 1976 which stated:

"All units in Transport Canada except those engaged in planning and policy-formulation activities or those conducting functional reviews are to have their operations reviewed at intervals of not more than three years."

19.60 The Air Operations Review Branch planned to review 16 locations for the fiscal year 1977-78. Some locations are scheduled for reviews on a frequency of only once every six years.

19.61 The Marine and Headquarters and Surface Operations Review Branch began operations in the late fall of 1977. The Marine Branch plans to review 15 locations in 1978-79 and the Headquarters and Surface Branch plans to review four locations.

19.62 *The mandate for operations reviews should be adhered to or it should be revised in the light of the number of operational units, known time requirements per review and staff resources available.*

19.63 **Reporting.** The Operations Review Branch in the Marine Administration reports to a director who in turn reports to the Administrator, whereas the Operations Review Branch in the Air

Administration reports directly to the Administrator. The Headquarters and Surface Operations Review Branch reports directly to a director general who in turn reports to the Deputy Minister. In the case of the Marine Administration, the reporting relationship may not ensure adequate emphasis and attention is given to this important function.

19.64 Each Operations Review Branch should report directly to an individual who reports directly to the Deputy Minister and is responsible for coordinating all internal audit functions.

19.65 Personnel resources. The personnel resources used by the three operations review branches vary in nature. The Air and Marine Operations Review Branches use seconded staff from other Transport locations similar to the location being reviewed. The Headquarters and Surface Branch uses only permanent reviewers. Several observations were made concerning the use of seconded staff.

19.66 A formal training program for seconded staff was developed approximately two years ago. However, the training program has not been given within the last year. The efficiency and effectiveness of using seconded staff for relatively short periods depends on both the individual's expertise in a particular discipline, as well as his skills as an evaluator and management auditor.

19.67 Methods of obtaining staff should be reviewed to develop a consistent policy on using seconded staff. This review should consider the benefits which seconded staff receive versus the audit efficiencies inherent in using full-time staff.

19.68 Review practices and procedures. Our review indicated that the operations review groups do not consistently follow established procedures and the procedures that are followed vary from one group to another. Specific findings include:

- Working papers were not prepared in a formal manner and do not include sufficient evidence to support the reports issued by the Operations Review Branch (Air).
- Recommendations were not made by the Operations Review Branch (Air) as required in a circular issued by the Deputy Minister.
- Procedures manuals did not exist for the guidance of reviewers (Headquarters and Surface).

19.69 Standard procedures should be established for the performance of operations reviews. These procedures should include:

- *required work steps and documentation standards;*
- *the extent of the evidence required as support for issued reports; and*
- *a requirement to include the use of recommendations in reports.*

19.70 Conclusion. The establishment of operational review groups represents a significant step in providing assurance to senior management concerning the efficiency of operational systems within the Department. Implementation of the above recommendations would improve the effectiveness of these groups.

Evaluation Branch

19.71 The Evaluation Branch was accorded official status by the Deputy Minister in 1975. Fourteen evaluations were completed as of March 31, 1978. As was the case with Operations Review, our work was limited to interviews and examination of information concerning the history, organization, reporting responsibilities and reports issued.

19.72 The Deputy Minister has issued a comprehensive mandate assigning the evaluation and reporting responsibilities of the group. Assignments are derived from specific directives of the Deputy Minister, advice from other departmental officials or from the Evaluation Branch itself. The mandate established this Branch as a "special projects group" in contrast to the other internal audit units which are intended to perform recurring review assignments within a comprehensive universe.

19.73 The Director General of Programming and Evaluation is responsible both for the programming function and for the Evaluation Branch and the Operations Review Branch for Headquarters and Surface. The assignment of these post-audit functions to the individual responsible for the challenge of departmental plans, appears to represent a conflict of interest. It is doubtful that the same individual can maintain the appearance of independence in this situation.

19.74 *The responsibilities for challenge of departmental plans and post-audit functions should be segregated.*

19.75 The establishment of the Evaluation Branch is a positive step towards providing senior management with significant information as to departmental problems, potential areas for improved efficiency or effectiveness, as well as areas of specific concern. Continued development of this Branch will enhance the Department's procedures to measure and report the effectiveness of programs through the use of internal audit.

Planning and Acquisition of Capital Assets

Introduction

19.76 This section contains the principal findings and recommendations resulting from our examination of seven capital projects carried out by the Department of Transport. These examinations are part of a government-wide review of capital projects which comprise one aspect of the Auditor General's Study of Procedures in Cost Effectiveness (SPICE). Chapter 3 of this Report, Planning Capital Acquisition Projects, contains a detailed account of this work, describes each project audited and specifies the major audit findings. This Chapter highlights findings particularly relevant to the Department of Transport and includes a summary of our observations on each project.

19.77 The capital acquisitions selected for audit were as follows:

	Estimated Final Cost (millions of dollars)
<u>Air Administration</u>	
Calgary International Airport	\$ 127.4
Toronto (Malton) International Airport	159.7

Additions	
<u>Marine Administration</u>	
Lightstation Automation	14.2
"R" Class Icebreakers	108.0
West Coast Vessel Traffic Management System	18.0
<u>Surface Administration</u>	
Motor Vehicle Test Centre	25.8
<u>Headquarters Administration</u>	
Transport Canada Training Institute	<u>58.0</u>
Total	<u>\$ 511.1</u>

19.78 The projects we examined were large, complex, costly and characterized by long development and construction periods. Moreover, some of the projects incorporated sensitive public policy objectives such as regional development.

19.79 Our examinations took the form of post-audits, examining results after the fact. Accordingly we were able to observe how actual events related to planning work that in most instances had begun seven or eight years ago.

19.80 Our audits disclosed serious deficiencies in the systems and procedures the Department used in acquiring capital assets in the projects we examined. Five of the projects did not achieve a reasonable standard of "due regard for economy."

19.81 The Department has recognized that these deficiencies exist and has introduced a number of initiatives in recent years to improve its capital acquisition procedures. We support these initiatives and refer to them in the discussion that follows. However, we have not attempted to assess their potential impact since they are in various stages of development and implementation. We will be evaluating them as part of our continuing work within the Department of Transport in the future.

Responsibility and Accountability for Projects

19.82 For several of the projects, responsibility and accountability were not clearly documented and communicated on a timely basis. This resulted in unclear lines of authority and delays in project execution which otherwise might have been avoided.

19.83 The Department is aware of the importance of clearly defining responsibility and accountability for all phases of major projects. The Department now defines project responsibilities through a management charter for major projects. Further, in 1976 the Department issued a Transport Canada

Project Management Policy and Guidelines manual to all administrations within the Department. This manual covers all aspects of project management including how to allocate responsibilities for project tasks.

19.84 *The Department should continue recent efforts to clearly define and communicate responsibility and accountability for capital projects.*

Documentation of Capital Proposals

19.85 Large, complex projects require thorough planning and analysis to support departmental approval and requests for capital and operating resources. In five of the seven projects examined, the documentation supporting the request for approval was clearly incomplete or inadequate to demonstrate due regard for the economy of these projects. We noted major weaknesses in the areas of analysis of needs, definition of objectives and intended effects, assessment of alternatives, realistic estimates of capital cost, and analysis of life-cycle costs.

19.86 Although there is a natural tendency for program managers and departments to advocate projects that will further their particular program's objectives, nevertheless, an objective assessment of each project is essential if the proper decision is to be reached in the approval process. In some cases we encountered advocacy planning without adequate formal documentation of all the relevant factors including, for instance, important project alternatives. During our examination, the Department advised us that project options and other analyses had been used in evaluating, approving and recommending a proposed course of action to the Treasury Board Secretariat. However, formal documentation to support this type of analysis was not always on file.

19.87 The Department is aware of the need to document proposals and to provide an "audit trail." To improve its project planning and control system, the Department established a Programming and Evaluation Group in 1975 with responsibility for monitoring and evaluating all major capital proposals.

19.88 *Capital proposals should be supported by accurate and complete documentation including:*

- *a proper analysis of needs;*
- *a clear statement of objectives and intended effects;*
- *an impartial assessment of alternatives;*
- *realistic capital cost estimates; and*
- *an analysis of life-cycle costs.*

Approval of Projects

19.89 As a project develops, its scope, design and costs advance from rough preliminary estimates to well-defined, firm estimates. At each phase of project development, approval should be sought for the funds needed to complete the next stage. Final approval should not be given until all the facts are in.

19.90 We noted that in a number of cases the Department committed itself to projects before the scope and design were finalized, realistic cost estimates were developed, and before firm agreements on rental rates and other charges for use of the facilities were reached. Therefore, the decision to

proceed with a project was not always based on realistic information which is essential to proper benefit-cost studies and up to date analyses of needs and alternatives.

19.91 To improve its evaluation and review process, the Department introduced new procedures in 1976. These procedures require managers to prepare detailed cost-benefit studies for significant projects. New projects have to be approved in stages and in accordance with standardized proposal documents, an Approval in Principle Document (APD) and a Program Approval Document (PAD). In addition, the Department has initiated a "counter-advocacy" review of all capital proposals over \$3 million through its Programming and Evaluation Branch.

19.92 *Final approval of all projects should be withheld until full information is available, including items such as detailed design, realistic cost estimates and rental commitments from major users.*

Project Control

19.93 The Department and the Treasury Board approve projects subject to conditions related to cost, size, technical performance and a construction schedule. Once projects have been approved, effective monitoring and control procedures are necessary to ensure that they are completed according to these conditions.

19.94 We found that procedures did not prevent significant increases in the cost and size of several of the projects. We also found instances where records of actual cost and performance could not be readily compared with original estimates.

19.95 *Project implementation should be properly controlled to ensure that facilities of an approved size and quality are completed on schedule and within the authorized budget.*

Post-Completion Review

19.96 The purpose of a post-audit or review of a major capital project is to determine whether the objectives of the project have been realized and to see how to improve similar projects in the future. Since the projects we audited have only recently been completed or are not yet complete, post-completion reviews have not been done. The Department has advised us, however, that a number of the projects will be reviewed.

19.97 *The Department should ensure that all capital projects are reviewed to determine the extent to which project objectives were achieved, to evaluate the performance of managers and to improve the planning and control of similar projects in the future.*

Case Histories of Capital Acquisitions

19.98 **Calgary International Airport.** The Department of Transport held consultations in 1971 with representatives of the City of Calgary, the Province of Alberta and the air carriers to plan the future development of Calgary Airport. The Department presented a number of alternatives for consideration, including both the expansion of the existing terminal and the construction of a completely new terminal on a new site. The air carriers expressed strong reservations as to the immediate need for, and concern about the cost of, new terminal facilities. On the other hand, the City of Calgary and the Province of Alberta favoured construction of new facilities as soon as possible.

19.99 In 1973, the Treasury Board approved the construction of a new air terminal complex within the existing airport boundaries. The first phase of the complex, opened in the fall of 1977, was planned to satisfy the 1980 forecast demand. However certain components, for example utilities, were designed to satisfy future development. Three subsequent phases are planned to provide capacity for estimated traffic growth to 1995.

19.100 In our opinion, the Department of Transport did not give due regard to economy in the Calgary Airport project. The written information provided by the Department to the Treasury Board in support of the initial request for approval was inadequate as a basis for evaluating the economy of the proposed project because:

- alternatives to the proposed new complex, such as the modification of the existing terminal, were not presented;
- the concerns expressed by the air carriers were not disclosed;
- financial information was incomplete;
- cost estimates, which were based on conceptual designs, were unrealistic; and
- the Department's written replies to certain questions posed by the Treasury Board officials were incomplete.

However, we understand that the Treasury Board Secretariat was informed orally that the existing terminal could be further modified and might suffice until 1979. Later requests to the Treasury Board for additional project funds did not update financial projections. Thus the impact of the increased capital costs on the future financial viability of the airport was not revealed.

19.101 The Department did not reach agreement with the air carriers on user-pay cost-recovery charges until just prior to the opening of the new terminal. The rates agreed upon will be substantially below those deemed necessary to achieve full cost recovery at the original planned rate. Although the present five-year agreement will be renegotiated upon expiry, there is no guarantee that cost recovery will be achieved over the life of the facilities. In our view, reaching an agreement on cost-recovery charges prior to the start of construction was essential to ensure concern for economy and discourage any unjustified user demands.

19.102 During the course of the project, the size and cost of the air terminal building increased substantially as compared with the original Treasury Board approval of the concept:

- Total size increased by 59% from 452,530 square feet to 720,550 square feet.
- Total cost increased by 255% from approximately \$21.3 million estimated in 1973 to \$75.7 million.

19.103 The Department attributes the increase in the size of the building to:

- changes arising from the preparation of detail design drawings;
- the provision for future utilities to meet the ultimate (1995) terminal development;
- the inclusion of United States preclearance requirements;

- the expansion of holdrooms to accommodate wide-bodied aircraft; and
- the addition of certain office and concession space.

The Calgary terminal is substantially larger than Toronto Terminal II when compared on an area per peak hour passenger basis in the design year of 1980. It is 5.5 times larger than the old terminal which it replaced. The Department advises that comparisons of air terminal buildings can be invalid for various reasons. However, it has been unable to demonstrate by other means that the size of the Calgary terminal is not out of line.

19.104 The increase in cost is attributed by the Department to the development of firm cost estimates based on detailed design drawings, the increase in the size of the terminal due to design changes and inflation. Although the exact impact of inflation is difficult to determine, construction cost indices show an inflation rate of approximately 65% between 1972 and 1977.

19.105 Although the design and construction of air terminal buildings to meet future requirements is a complex task, we are not satisfied that the Department's procedures were adequate to prevent any unnecessary increases in either the cost or size of the Calgary air terminal building. Specifically:

- Extensive authority was delegated to the Western Region without effective review, challenge and control by Headquarters.
- There was no clear acknowledgement by individuals within the administration of responsibility or accountability for the financial viability of the new airport complex once in operation.
- There were inadequate general area and cost criteria, based on comparable Canadian or foreign facilities, against which to monitor the project.
- No cost-benefit or life-cycle analyses were provided in support of major design changes.

19.106 **Toronto (Malton) International Airport Additions.** The Department of Transport received approval in 1973 for a project providing additional capacity at Malton Airport to handle traffic growth up to 1980, prior to opening a second airport in the Toronto area at Pickering. In 1975 the Department cancelled the proposed Pickering Airport thereby changing the perspective of the current expansion at Malton. The project involves the extension and modification of most of the airport facilities including two terminals, a road system, aircraft aprons and utilities plant, as well as new indoor parking facilities for Terminal II. The project is scheduled for completion in December 1981, although certain facilities such as the extension to Terminal II and adjacent parking facilities are already operational. The total estimated cost is \$159.7 million.

19.107 Our audit did not disclose any major deficiencies in the Malton project. Because the project was undertaken to meet short-range forecasts of traffic growth, the facilities are expected to be well-used as soon as available and an economic use of capital resources should result. However, we observed a number of weaknesses in project planning and control.

- Project objectives made no reference to the Department's "user-pay" policy. Agreement with the airlines on user charges was not reached before project approval except for Air Canada's office accommodation.

- The original estimate of \$54.6 million in 1973, which was based on conceptual designs and did not include highway access and internal road improvements, gave the Treasury Board little indication of the final cost. During the project, design changes arising partly because of the cancellation of the Pickering project had a substantial effect on costs, as did inflation.

19.108 **"R" Class Icebreakers.** In 1972, the Treasury Board approved a Department of Transport proposal for construction of a new "R" Class icebreaker at a cost of \$17.0 million to replace the N.B. McLean, then 42 year's old. In an effort to expedite the project, tenders for the hull and the propulsion machinery were called separately. None of the tenders for the hull was accepted but a contract was let for the propulsion unit. The Department subsequently proposed that the project be expanded to two "R" Class icebreaker at a total cost of \$60 million. The Treasury Board granted approval in May 1974. After tenders had been received, the Treasury Board, in April 1975, raised the approved ceiling to \$108 million. According to the Department, the increase was mainly due to inflation and to design changes.

19.109 The first ship, the *Pierre Radisson*, was delivered in May 1978. Its sister ship, the Franklin, will be delivered in 1979. Both are designed to operate in the St. Lawrence River and Gulf, on the Great Lakes and in the Arctic. Annual operating costs for each ship are estimated at \$2.5 million.

19.110 In our opinion, the Department of Transport did not give due regard to economy in the planning and approval phase of the "R" Class Icebreakers project. The formal documentation of analyses such as anticipated demand and planned service levels was inadequate to support project approval.

19.111 The proposal to acquire the icebreakers did not include a fleet plan to support the need for the two icebreakers. Such a plan should forecast needs for icebreaking services, proposed levels of service, the size of fleet required to provide those levels of service, and the economic benefits that would result. This type of documentation was essential to support the proposal to expand the size of the fleet.

19.112 Early capital cost estimates did not provide a good indication of the eventual cost. In addition, the proposal documents did not adequately analyse the continuing costs of operating and maintaining the ships and providing them with helicopters.

19.113 **Lightstation Automation.** In March 1970, the Treasury Board approved in principle a two-phase project of the Department of Transport for automating 258 manned lightstations "to improve lighthouse service and to reduce costs throughout the Aids to Navigation Service". In the late 1960s, the lightkeepers' union had initiated bargaining for specific hours of work. Traditionally, hours of work had been undefined as a lightkeeper's presence was required 24 hours a day.

19.114 The 1970 submission to the Treasury Board requested funding of \$14.3 million and identified potential savings of \$6.0 million annually. These savings were to be achieved by reducing the number of lightkeepers by 600, while adding 250 technicians to monitor and maintain the automated system. Automation of operations at each lightstation was budgeted in 1970 at \$6.6 million with a target completion date of March 1972. Reduction in lightstation personnel was to be achieved by reducing the lightkeeper job to surveillance. Equipment acceptance and organizational problems led to a six-year delay in completing this stage and some lightstations still have not been automated. Installation of a remote monitoring system was budgeted in 1970 at \$7.7 million and was to have been completed by 1978. The Treasury Board has now deferred approval of Phase II pending re-evaluation by the Department.

19.115 In our opinion, the Department did not give due regard to economy in the Lightstation Automation project.

19.116 We saw no evidence that the Department examined reasonable alternative ways of implementing the program. On installation, some of the equipment did not function to the satisfaction of lightstation users, primarily commercial fishermen, thereby contributing to delays and cost overruns.

19.117 Approval for the project was based on forecast cost savings to be achieved through a substantial reduction in the number of lightkeepers. However, the Department did not adequately evaluate the feasibility of achieving these reductions. In fact, the small reduction in lightkeeper staff achieved mainly at the beginning of the project has been partly offset by additional requirements for technicians and other support personnel.

19.118 Although the automation project was nation-wide, responsibility for its implementation was delegated to line managers in the regions. Our audit disclosed that regional managers were not held accountable for achieving project objectives on a timely basis within cost limitations.

19.119 The cost of Phase I of the project is now estimated at \$14.2 million including the effects of inflation. However, certain internal costs such as installation labour are not charged to the project. Therefore, this estimated cost does not represent the total cost of Phase I.

19.120 **West Coast Vessel Traffic Management System.** The Vessel Traffic Management System (VTMS) project of the Department of Transport is intended to reduce the risk of the collision or grounding of vessels and to decrease the risk of pollutants damaging the West Coast environment. The project was proposed as a developmental system to enable the Department's Marine Administration "to innovate and adopt air traffic control systems and techniques to marine traffic as they might apply". The project includes construction of remote radar installations on the lower coast of British Columbia to monitor marine traffic. Through radio and microwave links and automated tracking systems, the Coast Guard will monitor ship movements and provide weather and traffic information to mariners.

19.121 The project, originally approved by the Treasury Board in 1974 at an estimated cost of \$12.0 million, is now expected to cost \$18.0 million due to inflation and design changes. It is expected to be fully operational by the end of 1978.

19.122 Our audit did not disclose any major deficiencies in the West Coast VTMS project. We found, however, some weaknesses in the information supporting approval of the system and in the project cost system. The Department did not clearly define the experimental goals of the project. Possible lower-cost alternatives, such as a ship-to-shore radio system with manual plotting, were not thoroughly explored and documented. Approval was sought, based on rough cost estimates, before engineering studies were completed. The cost system did not report the cost of services that departmental specialists provided, and did not compare detailed costs with estimates for key parts of the project.

19.123 Since this project represents a developmental system, the Marine Administration should conduct a post-project review to ensure maximum benefits are obtained and to assist in planning future vessel traffic management systems.

19.124 **Motor Vehicle Test Centre.** The Department of Transport is responsible for determining whether motor vehicles and components comply with federal safety standards. To date, the Department has carried out motor vehicle testing using various facilities in Canada and the United States. In June 1974, the Department obtained approval in principle to construct a Canadian motor vehicle test facility

at a cost of \$10.3 million. The Motor Vehicle Test Centre is now scheduled for completion by the end of 1978 at an estimated cost of \$25.8 million including inflation.

19.125 In our opinion, the Department of Transport did not give due regard to economy in the planning of the Motor Vehicle Test Centre project.

19.126 The Department did not properly analyse and present alternatives to building a new test facility as a means of carrying out its responsibilities. It commissioned a feasibility study that directed the consultants to assess the design details of the proposed Centre rather than the costs, benefits and alternatives. Its submission to the Treasury Board did not compare the ongoing costs of the proposed Centre with the costs of alternatives. Estimates now show that, in addition to the capital expenditure of \$25.8 million, it will cost \$1.8 million a year to operate the new Centre. Continuation of the present level of safety testing would cost only \$800,000 a year.

19.127 The Department's submission to the Treasury Board indicated that construction of the Test Centre would increase automotive research and development in Canada, increase the number of technically qualified Canadian automotive personnel and restrict testing expenditures to Canada. It did not compare the effectiveness of the Centre in achieving these benefits with alternative courses of action.

19.128 The Department hopes to recover some portion of the Centre's operating costs through the rental of facilities and personnel to outside users. There was no quantitative analysis of demand or prospective revenues at the time of the original Treasury Board submission; nor had this analysis been completed by the time of our audit.

19.129 The cost estimate of \$10.3 million included in the submission approved by the Treasury Board in June 1974 was preliminary and did not provide a sound basis for benefit-cost analysis. The Department did not thoroughly reassess the project after design, engineering and cost studies had been completed and the final location at Blainville, Quebec had been selected. The 1974 submission had indicated that a location distant from Ottawa would preclude testing of the Government's National Capital Region motor vehicle fleet and would have other disadvantages.

19.130 **Transport Canada Training Institute.** The Training Institute of the Department of Transport, temporarily located in Ottawa, trains air traffic controllers, radio operators, electronic technicians, marine personnel and meteorological technicians. Transportation management courses also are provided. The construction of permanent facilities at Cornwall was approved in principle in 1973 at an estimated cost of \$31.5 million. On the basis of detailed designs and taking inflation into account, the Treasury Board raised the expenditure ceiling to \$49.8 million and construction began in 1975. Classes were to begin in September 1978 and relocation from Ottawa is to be completed by the fall of 1979. The capital cost has increased to \$58.0 million. According to the Department, the increase results largely from inflation. In 1980-81, the first full year of operation, forecasts provide for operating costs of \$11.6 million and the use of 308 man-years.

19.131 In our opinion, the Department did not demonstrate due regard for economy in the planning of the Training Institute project. There was inadequate formal documentation of the requirements for in-house training and the analyses of options to meet those requirements.

19.132 The Department did not prepare a formal benefit-cost study of the project, which should have been done in the early planning stages. Moreover, the Department did not adequately document the costs and benefits of the various options by which in-house requirements might have been met.

Possible options included, in particular, an incremental building program and phased decentralization from the National Capital Region.

19.133 Training forecasts presented in support of initial project approval did not account for a reduction in demand for Coast Guard cadet training in Cornwall as a result of a decision to retain all cadet training in Nova Scotia. Departmental management indicated however that new demands for other marine training would make up this shortfall and the original forecast was not changed. Also, the forecasts did not express demand in training days or years and did not provide written analyses of course scheduling and facilities usage rates.

19.134 Review procedures within the Department were insufficient to prevent the proposed facilities from increasing in size by 70,000 square feet after approval of the concept. A comprehensive financial report during the planning and estimating phase would have highlighted the cost of the increase.

Control Over Fixed Assets

Introduction

19.135 The operations of the Department of Transport require it to maintain custody of a broad range of fixed assets and supplies, from massive icebreakers and complicated aircraft to sophisticated telecommunications systems. Estimates of the cost of the fixed assets held by the Department exceed \$3,000 million.

19.136 Within the Department, responsibility for the safekeeping of these assets is delegated by the Deputy Minister through the different Administrators to Responsibility Centre Managers, who are the individual users of the assets. The physical controls and the accounting procedures to be followed by the asset holders and the accounting staff are set out in the Department's Supply Manual.

Fixed Asset Accounting System

19.137 The Department recently introduced a Fixed Asset Accounting System -- Transport (FAAST), to impose greater accounting control over the fixed assets. FAAST is a financial control system that uses the existing asset inventory records for custodial control. The main feature of FAAST is the production of financial control totals which are reconciled with the capital expenditure votes each year.

19.138 To determine whether the physical controls and accounting records were adequate to safeguard and control public property we examined the records at a number of operating locations and reviewed the records maintained at Headquarters for the Fixed Asset Accounting System. Our examinations were designed to establish the physical existence of the asset, to evaluate the individual accounting records, and to determine whether adequate, timely physical counts of these assets were being performed. The findings arising from our examinations are similar to those arising from previous examinations at locations in the Ottawa area.

Observations

19.139 The FAAST system is based on existing financial data which has been used to set up the opening balances of fixed assets held. These opening balances have not been verified by physical counts of the assets held in the various responsibility centers and as a consequence there is no assurance that the FAAST control totals represent assets actually on hand.

19.140 No timetable has been established for comparing the existing custodial record systems for mobile equipment, electronic equipment and furniture and fixtures with the FAAST financial system. Land, buildings and wharves are not controlled by a specific custodial system and a study is currently under way to identify and catalogue these assets. The study is scheduled to be finished within the next two years.

19.141 Our examinations disclosed the following weaknesses:

- a number of exceptions from published procedures contained in the Supply Manual were frequently noted at the locations visited. These included:
 - physical counts of fixed assets were not being done;
 - detailed fixed asset records are not being reconciled to financial control accounts; and
 - fixed assets on hand were not reflected in the records;
- adequate detailed records had not been established for certain classes of assets; and
- there was no basic control or implementation plan to ensure that present records and systems are integrated with the new FAAST system.

19.142 *The Department should ensure that all locations comply with the specific requirements of the Supply Manual.*

19.143 *A specific implementation plan and time schedule should be developed on a Department-wide basis to ensure that the Fixed Asset Accounting System-Transport system is properly integrated with the custodial records.*

19.144 *All existing fixed asset records should be verified, with the identification and cataloguing of land, buildings and wharves to be concluded as early as possible.*

19.145 *Responsibility for co-ordinating and monitoring the fixed asset control system throughout the Department should be delegated to a specific Headquarters officer.*

Human Resource Management

Introduction

19.146 This special study is another of the series of projects designed to explore and develop the concept of value-for-money audits and is part of an examination of human resource management in the Government of Canada. The focus is on whether money has been expended with due regard to economy and whether existing legislation, regulations and policies have been complied with.

19.147 The investigation initially covered almost the entire field of human resource management, except staff relations, to ensure that we would identify the most significant problem areas. However, because of the extreme breadth of the field, we gradually narrowed the emphasis to concentrate on manpower/organization planning, training and development.

19.148 We interviewed about 100 senior managers in both line and staff positions, covering department headquarters personnel and functional groups in Air, Marine and Surface Headquarters and in two regions of each of the Air and Marine administrations. Questionnaires and interview guides were prepared in advance, based primarily on an extensive advance study of central agency and departmental policies and regulations covering human resource management.

19.149 As befits a large complex organization with a heavy investment in people, the Department devotes a significant proportion of its resource man-years to the management and development of human resources. About two per cent of the authorized man-years are devoted to the personnel function and a further seven per cent are used for training positions and trainee time. All supervisory and managerial people also spend a substantial amount of time in continuing personnel management functions.

19.150 The Department of Transport is expending considerable effort to manage its human resources effectively. Although a number of specific weaknesses in both the manpower/organization planning and the training and development areas were uncovered during our study, the Department is aware of most of the problems identified.

19.151 Many initiatives are currently under way that promise to improve the Transport human resource management system substantially. Four examples are the revised employee performance evaluation system, the extension of the Career Review Board process downward to middle management levels, the newly increased emphasis on careful reporting of training and development cost data and the decision to maintain the excellent momentum created by the Cost Reduction Task Force by integrating its methodology into the "A" base review conducted by the Programming Group. An inventory of these initiatives has been prepared, and they will be considered for inclusion in our review during the next few years.

19.152 Our examination revealed no major problems in the classification, staffing and attendance, leave and overtime areas. We found no evidence that the Department failed to conform to the policies and regulations laid down by the Treasury Board and the Public Service Commission in the training and development and manpower/organization planning areas.

Manpower/Organization Planning

19.153 Although the Department adheres to the Treasury Board man-year control regulations, these do not by themselves constitute a satisfactory control on man-year utilization, since they do not require a regular review of the manning levels required for continuing programs. Consequently, despite some initiatives under the new Activity Management concept and the on-going "A" base review, the Department does not have adequate control over manpower levels in existing programs.

19.154 We found, however, that the Department has designed and has begun to implement a process to analyse man-year requirements for new and expanded programs. Although the total process, if implemented as currently planned, may eventually be a sound man-year control, the Programming information system is, as yet, only fully developed for capital projects review. However, the findings of other SPICE reports (for example, the report on the Lightstation Automation project) suggest that this process is not consistently applied. Several new ventures will probably influence the determination of appropriate manning levels for continuing activities. Some control also results from periodic operational reviews.

19.155 One of the most important recent developments in the Department's manpower/organization planning has been the Cost Reduction Task Force. It has directed managers attention to cost and staff reduction, demonstrated top management's concern about cost control and collected a great deal of valuable information. It has already achieved some small, but meaningful, freeing up of resources; by May 1978, according to departmental management, 217 jobs had been identified as available for reallocation to functions with higher priorities, with an expectation of a further 90 jobs being identified in the near future.

19.156 The methodology and momentum developed by the Cost Reduction Task Force should be maintained by permanently incorporating this type of rigorous approach into either the Operations Review or the Programming activity.

19.157 The Department agrees and is currently planning to meld the Cost Reduction Task Force methodology into the "A" base review conducted regularly by the Programming Group.

19.158 The Department also has a variety of planning and review techniques available that contain components for analysing man-year requirements, including Operations Review, Functional Review, the Programming Process and the Performance Measurement System. A policy established in the Department since 1977 requires a review to ensure the uniform application of all of these techniques to all sections of the organization every three to five years. However, only the Cost Reduction Task Force project has been applied across the board. The Department needs a consistently applied approach to man-year requirements analyses that is closely integrated with its strategic planning processes.

19.159 All the internal manpower planning approaches now in use should be assessed for utility and one of them, or a further variation, should be adopted by each major organizational unit in the Department. This approach should be linked closely to the Department's strategic planning process.

19.160 Although the Department is generally performing well in the individually-oriented aspects of manpower planning, we observed two closely related weaknesses in this process.

19.161 First, many of the statements of goals for individuals, small groups and even branches were so general that evaluation of performance against them would be difficult, if not impossible. Second, the performance appraisal processes used in the major components of the Department, bore no clear relationship to goals or lacked the means of measuring achievement of these goals.

19.162 Many of these performance appraisal processes depended almost entirely on "traits analysis", without reference to goal achievement. Traits analysis can provide valuable information for identifying skill deficiencies as well as those with promotional potential, both of which are important elements of any manpower planning system. It does not, however, provide as sound a basis for identifying poor, average and exceptional performers as a performance appraisal plan that also incorporates reference to goal achievement. This identification of performance levels is also an important component of any sound manpower planning system. A project is currently underway within the Department to upgrade the performance appraisal process.

19.163 The Department should strengthen its individual goalsetting process, relating it to departmental and program objectives.

19.164 The Department should design and implement the new employee performance appraisal system as soon as possible and base it upon clearly stated individual and group goals tied to objectives and the operational goals of the Department.

19.165 The Department agrees with this recommendation and has been working on such a system for some time, with completion scheduled for July 1978.

19.166 The Department has developed two computerized data bases for human resource management, capable of producing most of the information necessary for matching manpower resources to manpower requirements. However, the systems are not being used to their full potential. A related problem is that many potential users indicated a lack of confidence in the data in both the Personnel Activity Reporting System and the Personnel Management Information System. The Department engaged the Bureau of Management Consulting in April 1978 to conduct a study of both of these systems. A report is due early in July.

19.167 *A firm schedule should be adopted for final implementation of both personnel information systems, in order to obtain full value for money already invested in systems development.*

Training and Development

19.168 Although much of the groundwork has been laid, the Department still does not have an adequate system for the identification of training needs. For example, guidance to line managers in identification is weak and many managers indicated a lack of interest or a feeling of being unqualified to establish training needs.

19.169 *The Department should provide stronger direction for its training programs by:*

- *training managers in the identification of training needs;*
- *improving guidelines on the identification of training needs; and*
- *reiterating line managers' responsibilities to identify training needs.*

19.170 As noted previously, the present performance appraisal process relies almost exclusively on traits analysis, without reference to achievement of job goals. We believe that inclusion of an objective evaluation of the extent to which an individual achieves such goals would facilitate the identification of training needs, both in relation to individuals and the Department as a whole.

19.171 *The Department should facilitate the assessment of the effectiveness of the training program by completing the implementation of the upgraded performance appraisal process referred to in the manpower/organization planning section.*

19.172 New training courses are brought to the Transport Canada Training Council for approval before final development and without adequate benefit-cost analysis. Moreover, continuing programs are not subject to a regular review of their utility and effectiveness by the Council. For training conducted by resources located outside the Public Service, only very informal analysis of the quality or applicability of these courses is performed.

19.173 *The Training Institute should initiate an annual review of all courses purchased from external sources and a sample of internal ones. The review should focus upon achievement of course goals and an analysis of the cost-effectiveness of the course versus alternative teaching methods.*

19.174 For over 18 months, the Transport Canada Training Institute has been committed to initiating an improved training evaluation process. The development of a course to facilitate this process is

scheduled for completion in June 1978 and the course is planned to be in widespread use by the end of the year.

19.175 The schedule for disseminating the course on training evaluation should be accelerated and the procedures required to make the evaluation process operational should be implemented.

19.176 The Department lacks an adequate system for recording the costs of its training and development activities. The present system does not capture the cost of trainees' time and thus grossly understates training costs, making benefit-cost analysis difficult. The Training Institute has experienced difficulty in compiling historical cost trends for training. Many training costs find their way into other Operation and Maintenance accounts due to the low importance placed on rigour in cost reporting.

19.177 The Department, the Training Institute and the Administrations have developed a system for collating and approving requests for training. However, once the expenditures have been approved, the requesting manager is permitted to substitute other courses, providing total costs are not increased. Although specific reports of training actually undertaken are submitted, no analysis has been done of the degree of variance between the original plan and the types of training actually performed, or of the reasons for change. In addition, we observed large unexplained variations between planned and actual levels of training expenditures.

19.178 The cost of formal training and development activities, including the cost of trainees' time, salaries of trainers and course development costs, should be captured and reported in a uniform manner. Firm controls should be applied to ensure that all costs are captured and correctly identified.

19.179 Actual training costs incurred should be compared periodically to budget, the variances analysed and an explanation required from each cost centre deviating significantly from plan.

19.180 Because of the imperfect capturing of cost data and inadequate identification of training needs, the Department has had difficulty in forecasting the level of training activity. These factors, together with an apparent desire to predict that the new Cornwall facility will be fully used by 1980-81 have resulted in a significant and regular shortfall of actual training from planned training in recent years.

19.181 The Training Institute should adjust its method of projecting training man-days, both at Institute facilities and in the field, to take into account such factors as failure rates and dropout due to conflicting time pressures within the Department.

19.182 The Department should re-examine the five-year training projections to ensure their reliability as a basis for future decisions relating to training staff levels and the further development of training facilities.

19.183 In summary, the Department needs to implement a much more rigorous system to manage this \$50 million activity in order to ensure that the greatest value is being obtained for the money being spent.

The Airports Revolving Fund

19.184 The Airports Revolving Fund forms part of the operations of the Air Administration having been established in 1969 under the Authority of Appropriation Act, No. 3, 1969. Its purpose is to finance the operation and development of certain airports, on a cost-recoverable basis, to the maximum practicable

extent. At present, the Fund includes the airports at Montreal (Dorval), Montreal (Mirabel), Toronto (Malton) and Vancouver as well as the Pickering Airport Site at Toronto.

19.185 The relative amounts involved, based on the financial results for the year ended March 31, 1978, are as follows:

	<u>Number of Employees</u>	<u>Revenue</u>	<u>Net Income (Loss)</u>	<u>Assets at Cost</u>
		(thousands of dollars)		
Montreal (Dorval)	312	\$ 25,573	\$ 1,780	\$ 60,368
Montreal (Mirabel)	368	22,728	(51,548)	333,926
Toronto (Malton)	460	59,366	21,300	181,484
Vancouver	168	23,880	4,327	98,856
Pickering Site	=	=	=	<u>158,520</u>
	<u>1,308</u>	<u>\$ 131,547</u>	<u>\$ (24,141)</u>	<u>\$ 833,154</u>

19.186 An examination was performed on the accounts of the Airports Revolving Fund for the year ended March 31, 1978, in order to enable me to express an opinion on the financial statements. Treasury Board Circular 1970-7 requires that the financial statements are to be prepared on the basis of accrual accounting practices applicable in the private sector, and are to be certified by the Auditor General of Canada. The audit report on the financial statements was qualified with respect to certain matters as outlined in the paragraphs that follow.

19.187 All development costs associated with the Pickering Airport Project have been capitalized in the accounts and are shown as Deferred Pickering Development Costs on the balance sheet. These costs amounted to \$54.7 million as at March 31, 1978, and include the cost of planning, site preparation and interest on funds borrowed to acquire land. The construction of an international airport at Pickering has been deferred indefinitely pursuant to a Cabinet decision. Accordingly, in my opinion it is no longer appropriate to capitalize and reflect these costs as an asset. Had these costs not been capitalized, other assets and retained earnings would have been decreased by \$54.7 million and the loss for the year would have been increased by \$10.7 million. My report was qualified because the Fund capitalized development costs on the Pickering Project.

19.188 The Mirabel Airport reported a loss of \$51.5 million for the year ended March 31, 1978, and has reported accumulated losses of \$119.7 million since its opening in 1975. Management has advised that substantial losses are anticipated for the foreseeable future and due to the magnitude of these losses, continued financial support by Parliament is essential to the survival of the Airports Revolving Fund. As the recovery by the Fund of the \$291.7 million investment in facilities and equipment is dependent on the success of future operations my opinion was qualified.

19.189 No provision has been made in the accounts for termination benefits accruing to employees of the Canadian Air Transportation Administration operating the airports financed through the Airports Revolving Fund. The amount of the liability as at March 31, 1978, has not been calculated. My report was qualified in relation to the failure to record these accrued employee termination benefits.

19.190 During our examination we noted a number of weaknesses in accounting procedures and internal controls. These weaknesses and our recommendations were formally reported to the Department in a management letter. Most of them were not significant enough to warrant inclusion in this Report, except for one item of significance which is discussed in the next two paragraphs.

19.191 **Allocation of Costs to the Fund.** According to an administrative decision made when the Airports Revolving Fund was established in 1969, expenditures related to air traffic control and telecommunications and electronics services directly attributable to terminal control were excluded from the accounts of the Fund. Consequently the present financial statements of the Fund do not include these costs, which relate to activities integral to the operations of the airports, estimated at \$17.8 million for 1976-77.

19.192 *All costs related to the operations of the airports within the Airports Revolving Fund should be charged to the Fund in accordance with Treasury Board Circular 1970-7.*

Related Crown Corporations and Agencies

Canadian Transport Commission

19.193 The Canadian Transport Commission reports to the Minister of Transport and complements the activities of the Department of Transport. The Commission is a dual purpose body acting both as a court of record, when dealing with the regulation and licensing of the various modes of transport, and as a means of exercising control over rates and tariffs. In addition, the Commission administers certain transportation subsidy programs.

19.194 Operations of the Commission are conducted through the following Committees:

- Railway Transport Committee,
- Air Transport Committee,
- Water Transport Committee,
- Motor Vehicle Transport Committee,
- Commodity Pipeline Transport Committee, and
- Review Committee.

In addition, a research division carries out studies relating to the development and regulation of the various modes of transportation.

19.195 Operating expenditures of the Commission amounted to \$23.3 million, contributions amounted to \$43.0 million, and statutory payments amounted to \$331.9 million for the fiscal year ended March 31, 1978. As at March 31, 1978, the Commission employed 886 people.

19.196 In line with the Audit Office's emphasis on cyclical auditing, an examination of the accounts relating to the Commission was not conducted in 1977-78. However, the Commission has been scheduled for a full examination in 1978-79, the results of which will be included in the 1979 Report.

National Harbours Board

19.197 The National Harbours Board under authority of the National Harbours Board Act, *R.S., c. N-8*, is responsible for the operation of 13 ports, two grain elevators and two bridges. The Board promotes the utilization of national harbours and provides facilities for the berthing of vessels and the handling and protection of water borne transit cargo.

19.198 For the year ended December 31, 1977, the Board had consolidated operating revenues of \$98 million, parliamentary appropriations of \$3.4 million and approximately 2,300 employees.

19.199 Summarized operating results of each of the Board's facilities for the year ended December 31, 1977, are as follows:

	<u>Income</u>	<u>Expense</u>	<u>Net Operating (Loss) Gain</u>
	(thousands of dollars)		
St. John's	\$ 732	\$ 1,031	\$ (299)
Halifax	5,993	7,038	(1,045)
Saint John	4,847	6,239	(1,392)
Belledune	96	92	4
Sept-Îles	677	652	25
Chicoutimi	514	357	157
Baie des Ha! Ha!	110	33	77
Quebec	5,633	5,586	47
Trois Rivières	1,024	1,239	(215)
Montreal	25,919	29,975	(4,056)
Jacques Cartier Bridge	130	3,087	(2,957)
Champlain Bridge	4,742	5,827	(1,085)
Prescott	1,771	1,520	251
Port Colborne	1,181	1,250	(69)

Churchill	5,220	4,135	1,085
Vancouver	39,241	36,793	2,448
Prince Rupert	<u>300</u>	<u>1,194</u>	<u>(894)</u>
	<u>\$ 98,130</u>	<u>\$ 106,048</u>	<u>\$ (7,918)</u>

19.200 An audit was performed on the Board in 1977-78. The primary purpose of the examination was to enable me to express an opinion on the financial statements for the year ended December 31, 1977, as required by the National Harbours Board Act. The Office is also required to report under the Financial Administration Act as to whether proper books of account have been kept by the Board, the financial statements are in agreement therewith and the transactions that have come under our notice have been within the Board's statutory powers.

19.201 The audit report on the financial statements of the Board as of December 31, 1976, contained the following qualification: "except for the required effects of any adjustment which might have been disclosed if adequate documentation of the estimated useful lives of fixed assets had been available". During 1977, the Board carried out a major review of its fixed assets and recorded a special depreciation charge of approximately \$134 million. As a result, it was no longer necessary to qualify my opinion, however I did include comments as to changes in two accounting policies:

- This year the Board began depreciating fixed assets in the year of acquisition. The previous policy had been to begin depreciation charges in the year following acquisition. The effect of this change as stated in the notes to the financial statements was \$11.1 million due to the effect of applying the new policy retroactively.
- In 1977, the Board treated parliamentary appropriations as an item of income in the financial statements. These amounts had previously been treated as contributions and were reflected in the Statement of Deficit.

19.202 During our examination, we noted a number of weaknesses in accounting procedures and internal controls. These weaknesses and our recommendations were formally reported to the Board in a management letter. Most of these weaknesses and recommendations were not significant enough to warrant inclusion in this Report except for one item of significance outlined in the paragraphs that follow.

19.203 On July 15, 1976, the National Harbours Board opened tenders on a project for refacing the elevator dock at the Port of Prescott. Governor in Council authorization was received on September 14, 1976, to enter into a contract with the low bidder at a price of \$1.1 million. This authorization came one day after the expiry of the 60 day period during which the bidder was committed to his tender. The low bidder declined the contract. Once again tenders were called and were opened on November 4, 1976. The accepted bid was in the amount of \$1.3 million.

19.204 An increase in the cost of the project of approximately \$200,000 was caused by not requesting Governor in Council authorization on a timely basis.

19.205 *The Board should implement procedures which ensure the timely processing of submissions for Governor in Council approval.*

St. Lawrence Seaway Authority

19.206 The St. Lawrence Seaway provides a deep waterway from the Port of Montreal to the Great Lakes, bringing the inland cities into direct contact with the major seaports of the world. The Canadian portion of the deep waterway is operated by the St. Lawrence Seaway Authority which was created in 1951 by the St. Lawrence Seaway Act. The Authority is charged with constructing, maintaining and operating the deep waterway and charging tolls sufficient to cover its operating costs.

19.207 Tolls are the joint concern of both the Government of Canada and the Government of the United States. Before any changes can be effected in the tolls structure, agreement must be reached at both the government level and with the Seaway Development Corporation, the Seaway Authority's American counterpart. A revised toll structure has recently been agreed to, the first portion of the increase to take effect April 1, 1978.

19.208 The Authority employs 1,249 people and operates approximately nine months of the year. It incurred a loss of \$22.0 million during the year of which \$19.3 million was recovered from the Consolidated Revenue Fund.

19.209 An audit was performed on the Authority in 1977-78. The primary purpose of the examination was to enable me to express an opinion on the financial statements for the year ended March 31, 1978, as required by the St. Lawrence Seaway Authority Act. The Office is also required to report under the Financial Administration Act as to whether proper books of account have been kept by the Authority, the financial statements are in agreement therewith and the transactions that have come under my notice have been within its statutory powers.

19.210 In prior years my audit report was qualified because of failure to provide for depreciation on all depreciable assets and to accrue employee termination benefits. As part of the refinancing plan described below, the Authority retroactively adopted the policy of providing for depreciation on all depreciable assets except interest amounting to \$32.8 million which was capitalized during construction of the Welland Modernization Project. It is anticipated that this interest will be cancelled and reversed in the near future as part of the second phase of the refinancing of the Authority. In addition, the Authority retroactively adopted the policy of accruing for employee termination benefits in the period in which the benefits are earned by the employees. As a result of these changes, I am pleased to report that it is now no longer necessary for me to qualify my report.

19.211 The refinancing plan referred to above, was part of an overall plan whereby the Authority would become self supporting. A key element of this plan was the negotiation of revised tariff tolls to provide for incremental increases of rates over a three-year period commencing with the opening of the 1978 navigation season. With the approval of Parliament, this plan also provided for the conversion of \$624.9 million of loans from Canada to contributed capital as of April 1, 1978. Effective April 1, 1977, further accrual of interest on the deferred interest payable of \$216.4 million was discontinued as approved by the Governor in Council. It is the intention of the Authority to seek approval from Parliament to have the remaining deferred interest payable cancelled and reversed. The Authority has also offset \$121.0 million of contributed capital against deficits incurred prior to March 31, 1978.

19.212 The parliamentary appropriation authorizing the conversion of the loans from Canada to equity authorizes the Minister to fix, from time to time, that amount that shall be paid by the Authority annually

out of its toll revenue as return on capital. It is anticipated that no return on capital will be required until the new toll structure is fully implemented over the next three years.

19.213 During our examination, we noted a number of weaknesses in accounting procedures and internal controls. These weaknesses and our recommendations were formally reported to the Authority in a management letter; however, they were not significant enough to warrant inclusion in this Report.

Pilotage Authorities

19.214 Following the recommendation of the Royal Commission on Pilotage, four pilotage authorities (Atlantic, Great Lakes, Laurentian and Pacific) were established under the provisions of the Pilotage Act, 1970-71, c. 52. Services provided by the Authorities include ships' pilots, pilot boats and other services required to ensure the safe and orderly passage of ships through designated waters. Tariffs have been established in each district that are designed to eventually recover the cost of providing these services from the users. Pilotage services are provided on a year round basis, 24 hours a day, with the exception of the Great Lakes Pilotage Authority which is inactive during the winter months when the St. Lawrence Seaway is closed. To date only the Laurentian Pilotage and Pacific Pilotage Authorities have achieved full cost recovery.

19.215 The relative significance of the Authorities can be shown as follows:

	<u>Number of Employees</u>	<u>Revenue</u>	<u>Net Income (Loss)</u>
		(thousands of dollars)	
Atlantic	111	\$ 2,780	\$ (1,097)
Great Lakes	133	6,413	(836)
Laurentian	84	14,867	238
Pacific	60	8,292	501

19.216 An audit was performed on each of the pilotage authorities in 1977-78. The primary purpose of the examination was to enable me to express an opinion on the financial statements for the year ended December 31, 1977, as required by the Pilotage Act. The Office is also required to report under the Financial Administration Act as to whether proper books of account have been kept by the Pilotage Authorities, the financial statements are in agreement therewith and the transactions that have come under my notice have been within their statutory powers. The audit report on each of the financial statements contained no qualifications, however my opinion relating to the Pacific Pilotage Authority commented on the change to a new accounting policy whereby a lease for a pilot boat was capitalized. This treatment is now consistent with the other pilotage authorities.

19.217 During our examination, we noted a number of weaknesses in accounting procedures and internal controls. These weaknesses and our recommendations were formally reported to the respective pilotage authority in a management letter; however, they were not significant enough to warrant inclusion in this Report.

Northern Transportation Company Limited

19.218 Northern Transportation Company Limited provides one of the principal transportation lifelines serving the northern community's freight needs. The Company provides logistic support for oil, gas and mineral exploration and development throughout the Mackenzie River system and along the western arctic coast and islands. The Company also serves six coastal communities on Hudson Bay out of the Port of Churchill, Manitoba. In addition to its marine operations, the Company operates a wholly-owned trucking subsidiary which provides a general merchandise trucking service to a number of northern Alberta communities and to three centres in the Northwest Territories.

19.219 For the year ended December 31, 1977, the Company had revenues of \$24.9 million and a net loss of \$ 1.5 million. The accumulated deficit at December 31, 1977, amounted to \$9.5 million. The Company employed 107 people at December 31, 1977.

19.220 An audit was performed on the Northern Transportation Company Limited in 1977-78. The primary purpose of the examination was to enable me to express an opinion on the financial statements for the year ended December 31, 1977, as required by the Canada Business Corporations Act. The Office is also required to report under the Financial Administration Act as to whether proper books of account have been kept by the Company, the financial statements are in agreement therewith and the transactions that have come under my notice have been within its statutory powers. The audit report on each of the financial statements contained no qualifications.

19.221 During our examination, we noted a number of weaknesses in accounting procedures and internal controls. These weaknesses and our recommendations were formally reported to the Company in a management letter, however they were not significant enough to warrant inclusion in this Report.

Other Crown Corporations

19.222 The Auditor General of Canada is not auditor of a number of Crown corporations including the Canadian National Railway Company, Canadian National Marine Corporation, Via Rail Inc. and Air Canada. These organizations report to the Minister of Transport as do those entities discussed in previous sections of this Chapter for which the Auditor General is the auditor.

19.223 Under Section 14 of the Auditor General Act, 1976-77, c. 34, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation. Reports and opinions issued by the auditors of these companies may be viewed in Volume III of the Public Accounts of Canada or in the Company's published annual report.

Summary of Recommendations and Department's Comments

Results of Financial Audit

Recommendation

19.26 The Department should expedite the completion of a comprehensive operating agreement establishing the terms and conditions under which the Canadian National Marine Corporation (CNMC) will operate the specified ferry services.

Department's Comment

Agreed. A Tri-partite agreement between CNMC, CNR and Transport Canada is currently being negotiated and is expected to be in place by December 31, 1978.

Recommendation

19.29 Departmental procedures should be established to ensure that all translation requirements are referred to the Translation Bureau.

Department's Comment

Agreed. The Department will clarify with the Secretary of State the intent of the Translation Bureau Act with respect to the unique requirements for technical publications. This matter is also the subject of a current evaluation study which should resolve the problem.

Recommendation

19.32 The Department should take steps to ensure that payments for services not received are avoided in the future.

Department's Comment

Agreed. This contract did not have an on-hire/off-hire clause, but it could be included in all such charter agreements in the future. It is contended, however, that this will result in a substantially higher daily charter rate, particularly in circumstances similar to those of this contract, when the chartered vessel will be employed in evaluation programs of a develop mental and experimental nature en tailing a higher-than-usual operational risk.

Recommendation

19.34 Significant monthly variances should be analysed and the reasons documented. This documentation should contain plans for corrective action where necessary and notification as to the need for or availability of funds.

Department's Comment

Agreed. Steps will be taken to enforce existing directives outlining budgetary reporting standards and criteria.

Recommendation

19.36 The Department should take steps to ensure that only authorized individuals are allowed to certify requests for payments and that all required approvals are obtained before payment.

Department's Comment

Agreed. Steps have been taken to ensure that approvals of authorized individuals only are obtained before payments are made.

Internal Audit

Recommendation

19.47 The Financial Audit and Review Branch should report to an individual independent of the financial function, who reports directly to the Deputy Minister and is responsible for co-ordinating all internal audit functions.

Department's Comment

Agreed.

Recommendation

19.49 The Branch should develop a multi-year audit plan based on a clearly defined audit universe and taking into account high-risk elements, expected staff resources, a rotation of coverage and an analysis of costs versus benefits. The audit plan should be reviewed and approved by the audit committee.

Department's Comment

Agreed. Action is currently being taken to develop a long-range audit plan. When completed this plan will be presented for approval by the audit committee.

Recommendation

19.51 The Branch should establish a firm timetable for completing the manual and should ensure that the manual is completed in accordance with this schedule.

Department's Comment

Agreed. A firm timetable for completion of the audit manual by March 31, 1979 has been developed.

Recommendation

19.54 The Branch should develop and implement standards and procedures covering all aspects of working paper documentation including the scope adopted, work performed, conclusions reached and supervisory reviews completed.

Department's Comment

Agreed. This is being undertaken as part of the development of the audit manual dealt with above.

Recommendation

19.55 Before starting field work, detailed work programs should be prepared and approved. These programs should document the basis for selecting audit samples, the size of samples to be obtained and the method of selection.

Department's Comment

Agreed. Work programs are now being prepared and approved prior to commencement of field work.

Recommendation

19.62 The mandate for operations reviews should be adhered to or it should be revised in the light of the number of operational units, known time requirements per review and staff resources available.

Department's Comment

Agreed. This is being addressed as part of the introduction of a comprehensive audit function within the Department.

Recommendation

19.64 Each Operations Review Branch should report directly to an individual who reports directly to the Deputy Minister and is responsible for coordinating all internal audit functions.

Department's Comment

Agreed. Operations Review reports are considered by the Audit Committee chaired by the Deputy Minister.

Recommendation

19.67 Methods of obtaining staff should be reviewed to develop a consistent policy on using seconded staff. This review should consider the benefits which seconded staff receive versus the audit efficiencies inherent in using full-time staff.

Department's Comment

Agreed. Given the current man-year and dollar restraints, seconded personnel use under the direction of full-time operations review staff is the best available alternative to full-time staffing. This also provides a career development opportunity.

Recommendations

19.69 Standard procedures should be established for the performance of operations reviews. These procedures should include:

- required work steps and documentation standards;
- the extent of the evidence required as support for issued reports; and
- a requirement to include the use of recommendations in reports.

Department's Comment

Agreed.

Recommendation

19.74 The responsibilities for challenge of departmental plans and post-audit functions should be segregated.

Department's Comment

Agreed. These two functions are performed in separate units under a single official who reports directly to the Deputy Minister.

Planning and Acquisition of Capital Assets

Recommendation

19.84 The Department should continue recent efforts to clearly define and communicate responsibility and accountability for capital projects.

Department's Comment

The Department's initiatives in the last 2-3 years in the development of more comprehensive management processes have been aimed at providing a clearer perception of capital project responsibility and accountability.

Recommendations

19.88 Capital proposals should be supported by accurate and complete documentation including:

- a proper analysis of needs;
- a clear statement of objectives and intended effects;
- an impartial assessment of alternatives;
- realistic capital cost estimates; and
- an analysis of life-cycle costs.

Department's Comment

Agreed. A mandatory corporate programming process has been developed and has been in operation since 1976, providing for an independent review and analysis function to be exercised in regard to capital project proposals. This process includes the requirements listed.

Recommendation

19.92 Final approval of all projects should be withheld until full information is available, including items such as detailed design, realistic cost estimates and rental commitments from major users.

Department's Comments

Agreed. Treasury Board regulations require approvals in three stages:

- approval in principle based on conceptional design and best information available at the time;
- program approval based on detail design and specifications and corresponding more precise information; and

- contract approval based on firm bids.

This practice is followed by the Department.

Recommendation

19.95 Project implementation should be properly controlled to ensure that facilities of an approved size and quality are completed on schedule and within the authorized budget.

Department's Comment

A Transport Canada Project Management Policy has been in operation since 1976 and defines, in specific terms, mandatory requirements for project management and outlines a recommended approach to be followed to provide adequate control over funds and resources.

Recommendation

19.97 The Department should ensure that all capital projects are reviewed to determine the extent to which project objectives were achieved, to evaluate the performance of managers and to improve the planning and control of similar projects in the future.

Department's Comment

Agreed. Responsibilities and procedures for review are in place and are being practised in accordance with Transport Canada Project Management Policy of 1976.

Control Over Fixed Assets

Recommendation

19.142 The Department should ensure that all locations comply with the specific requirements of the Supply Manual.

Department's Comment

Agreed. Steps are being taken to this end.

Recommendations

19.143 A specific implementation plan and time schedule should be developed on a Department-wide basis to ensure that the Fixed Asset Accounting System-Transport system is properly integrated with the custodial records.

19.144 All existing fixed asset records should be verified, with the identification and cataloguing of land, buildings and wharves to be concluded as early as possible.

Department's Comments

Agreed. We are now preparing a specific plan defining the method and time-frame in which various sub-systems will be integrated with the Fixed Assets Accounting System, and the records verified by physical inspection of the assets held.

Recommendation

19.145 Responsibility for co-ordinating and monitoring the fixed asset control system throughout the Department should be delegated to a specific Headquarters officer.

Department's Comment

Responsibility for co-ordinating and monitoring the fixed asset control system throughout the Department has been assigned to the Director of Budgets and Financial Services.

Human Resource Management

Recommendation

19.156 The methodology and momentum developed by the Cost Reduction Task Force should be maintained by permanently incorporating this type of rigorous approach into either the Operations Review or the Programming activity.

Department's Comment

Agreed. The Department decided early in 1978 that the Programming Branch would assume the responsibility for the 'A' base review function to continue the momentum developed by CRTF.

Recommendation

19.159 All the internal manpower planning approaches now in use should be assessed for utility and one of them, or a further variation, should be adopted by each major organizational unit in the Department. This approach should be linked closely to the Department's strategic planning process.

Department's Comment

Agreed.

Recommendations

19.163 The Department should strengthen its individual goalsetting process, relating it to departmental and program objectives.

19.164 The Department should design and implement the new employee performance appraisal system as soon as possible and base it upon clearly stated individual and group goals tied to objectives and the operational goals of the Department.

Department's Comments

Agreed. This is an integral part of the development of the departmental performance review and appraisal procedures started a year ago. The Department has recently completed a major task begun in May 1977 involving the identification of strategic objectives, and the associated policies and strategies required to achieve these objectives. See also comment against 19.171.

Recommendation

19.167 A firm schedule should be adopted for final implementation of both personnel information systems, in order to obtain full value for money already invested in systems development.

Department's Comment

Agreed. The issue is currently under active consideration.

Recommendations

19.169 The Department should provide stronger direction for its training programs by:

- training managers in the identification of training needs;
- improving guidelines on the identification of training needs; and
- reiterating line managers' responsibilities to identify training needs.

Department's Comments

Agreed. Training of trainers to conduct this program is underway and incorporates guidelines on identification of training needs. Managerial responsibility in this area is being re-emphasized through this and several other training programs.

Recommendation

19.171 The Department should facilitate the assessment of the effectiveness of the training program by completing the implementation of the upgraded performance appraisal process referred to in the manpower/organization planning section.

Department's Comment

Agreed. This project is proceeding with a high priority but will take at least 12 months to complete. See also comments against 19.163 and 19.164.

Recommendation

19.173 The Training Institute should initiate an annual review of all courses purchased from external sources and a sample of internal ones. The review should focus upon achievement of course goals and an analysis of the cost-effectiveness of the course versus alternative teaching methods.

Department's Comment

Agreed. The means and timetable for implementation of such a review are being developed.

Recommendation

19.175 The schedule for disseminating the course on training evaluation should be accelerated and the procedures required to make the evaluation process operational should be implemented.

Department's Comment

Agreed. This is being done consistent with the resources available and with appropriate scheduling of the training involved.

Recommendation

19.178 The cost of formal training and development activities, including the cost of trainees' time, salaries of trainers and course development costs, should be captured and reported in a uniform manner. Firm controls should be applied to ensure that all costs are captured and correctly identified.

Department's Comment

Agreed. A system is being developed.

Recommendation

19.179 Actual training costs incurred should be compared periodically to budget, the variances analysed and an explanation required from each cost centre deviating significantly from plan.

Department's Comment

Agreed. A system is being developed.

Recommendation

19.181 The Training Institute should adjust its method of projecting training man-days, both at Institute facilities and in the field, to take into account such factors as failure rates and drop-out due to conflicting time pressures within the Department.

Department's Comment

Agreed. A statistical base is being developed to permit this.

Recommendation

19.182 The Department should re-examine the five-year training projections to ensure their reliability as a basis for future decisions relating to training staff levels and the further development of training facilities.

Department's Comment

Agreed. Such re-examinations are a continuing process in the Department.

The Airports Revolving Fund

Recommendation

19.192 All costs related to the operations of the airports within the Airports Revolving Fund should be charged to the Fund in accordance with Treasury Board Circular 1970-7.

Department's Comment

Agreed. A proposal to the Treasury Board to revise the Airports Revolving Fund to provide for the allocation of the costs of air traffic control and telecommunications and electronics services related to the provision of airport terminal control is now being prepared. Subject to approval of this proposal, such costs will be allocated to the Fund commencing with the 1979-80 fiscal year.

National Harbours Board

Recommendation

19.205 The Board should implement procedures which ensure the timely processing of submissions for Governor in Council approval.

Department's Comment

Agreed. Systems within the Department are in existence. In this particular instance, unique circumstances occurred which largely were beyond the control of the Board.

In addition, the Department has made the following comments on our observations relating to the capital projects discussed in paragraph 19.76 to 19.134.

"AUDIT TRAIL OF THE PROJECT APPROVAL PROCESS: The comments on the lack of audit trails relate to capital projects undertaken prior to the introduction of the Approval in Principle Document/Program Approval Document (APD/PAD) system early in 1976. Before this date, it had been the practice to give much of the substantiations for new capital projects in the form of oral presentations to Treasury Board officials in considerable detail. It is unfortunate that notes on these presentations have not always been retained. However, the fact remains that Treasury Board Secretariat was sufficiently satisfied with the justifications to approve the projects, and it would have been up to them to either ask for additional information or turn down requests for approval on the basis of non-substantiation. In any event, steps have been taken to make audit trails more visible for future reference.

CAPITAL COST FORECASTING: The use of current dollars in your report, to make cost comparisons between years, ignores the effects of inflation. This exaggerates the increases in costs experienced in the projects reviewed. Transport Canada, like all other departments, has followed Treasury Board Secretariat's policy in treating current or constant dollars.

USER PAY-COST RECOVERY: While the 1973/74 and earlier Blue Books of Estimates recognized the Canadian Air Transport Administration's acceptance of the user pay or cost recovery concept, it was not until 1 December 1974 that the Air Transport Tax was introduced. Since that date, the department has taken steps to consult with air carriers on cost recovery.

TECHNICAL CONSIDERATIONS: There appears to be a difference of opinion between your staff and our technical experts related specifically to project comparability in the case of the Calgary air terminal and the implementation of Lightstation Automation. It is respectfully suggested that in these cases, there is no choice but to defer to the technical experts on matters concerning the adequacy of standards, project requirements and analytical procedures.

IMPACT OF THE POLITICAL PROCESS: Recognition of the political process is not evident in reports (eg the choice of sites for the Training Institute and the Motor Vehicle Test Centre or the need for, timing of, and capacity of the Toronto International and Calgary airport). The early commitments made by ministers based on circumstances extraneous to the department, were particularly significant in the decisions on the timing, location, size and scope of these projects. The strength of these early commitments made it difficult to contain projects at later stages.

In the case of the Motor Vehicle Test Centre, the early analysis led to a location close to Ottawa for technical reasons and accessibility to HQ users. The Treasury Board, however, rejected the first proposal claiming that the department had not considered the policy of decentralization. The resultant delays in studying alternative sites contributed to increased costs and your resultant observations."

1978 Report of the Auditor General of Canada - Chapter 20

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Observations on the Financial Statements and Operations of Crown Corporations and Other Entities</H1>

</CENTER>

<HR>

20.1 Introduction. As Auditor General of Canada, I am the appointed auditor of 40 Crown corporations and 50 other entities listed in paragraphs 20.19 to 20.21. In this capacity, I examine and report on each entity's accounts and financial statements.

20.2 Part VIII of the Financial Administration Act defines the scope of my examination of the accounts and statements of Crown corporations and Section 5 and 6 of the Auditor General Act define that scope for other entities. My examinations were conducted in accordance with generally accepted auditing standards as recommended by the Canadian Institute of Chartered Accountants.

20.3 Both statutory obligations and professional accounting and reporting standards governed my reporting responsibilities. In connection with agency and proprietary Crown corporations (classified as Schedules C and D corporations respectively by the Financial Administration Act) my reporting mandate is governed by provisions of that Act. My audit reports on these corporations expressed my opinion as to whether the financial statements exhibited a true and fair view of the corporation's affairs in accordance with generally accepted accounting principles as promulgated by the Canadian Institute of Chartered Accountants.

20.4 My audit reports on the following organizations were expressed in relation to each entity's defined accounting policies as described in notes to their financial statements. Often these policies are similar to those of their associated departments.

Departmental corporations (classified as Schedule B corporations to the Financial Administration Act)

Agricultural Products Board

Canada Council

Exchange Fund Account

Royal Canadian Mounted Police (Dependants) Pension Fund

20.5 My audit reports on all other entities such as revolving funds, working capital advances and other organizations not listed in schedules to the Financial Administration Act expressed my opinion as to whether their financial statement disclosure conformed with generally accepted accounting principles.

20.6 I further reported, as required by the Financial Administration Act, as to whether proper accounting records had been kept for each agency and proprietary Crown corporation, whether these

records were in agreement with the audited financial statements and whether the transactions which came under my notice were within the corporation's statutory powers.

20.7 I have qualified my reports on some of the corporations and other entities where I concluded:

- the scope of my examination was limited;
- either deficiencies or inconsistencies existed in the application of stated accounting principles;
- proper books of account had not been kept and they did not agree with the financial statements presented for audit; and
- not all of the corporation's transactions which came under my notice were within its statutory powers.

20.8 The Standing Committee on Public Accounts devoted much time discussing issues raised in my 1976 and 1977 Reports concerning the financial management, control and accountability of Crown corporations. The Committee's deliberations culminated in its Second (Crown corporations) Report to the House of Commons dated April 11, 1978 (reproduced in Appendix E), which incorporated most of the recommendations contained in Chapter 9 of my 1977 Report. Among the recommendations in the Committee's report are the following proposals directed towards improving standards of financial disclosure and establishing audit requirements for government owned and controlled corporations dependent on public funds:

- adequate information on spending plans to be provided to Parliament and the Government on an integrated basis;
- improved financial reports based on generally accepted accounting principles to be published in the Public Accounts;
- mandates for auditors to be set that include reporting where money has been expended without due regard for economy or efficiency or where satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented;
- the Comptroller General to be given clear responsibility for providing guidelines that set acceptable standards of financial management and control; and
- the Treasury Board to take immediate action to remedy existing deficiencies.

20.9 The more significant of the qualifications in my reports on corporations and other entities appear in paragraphs 20.10 to 20.18 except for those relating to the Airports Revolving Fund which appear in Chapter 19.

20.10 Agricultural Stabilization Board - Lack of documentation supporting cattle deficiency expenditure. In 1977 the Minister of Agriculture announced the Cattle Stabilization Program, intended to reimburse producers of cattle sold for slaughter in 1976 for costs in excess of the support price. Eligible producers were required to submit a claim for payment accompanied by proof of slaughter to the Agricultural Stabilization Board.

In November 1977 the Board decided to return the proof of slaughter documents to producers and, therefore, we were unable to verify the propriety of claims in respect of which approximately \$38 million was paid. My report to the Minister on the financial statements of the Board for the year ended March 31, 1978, was qualified accordingly.

20.11 Canadian Arsenals Limited - Failure to record fixed assets and depreciation. The Company uses fixed assets which cost approximately \$22.8 million. Those purchased with funds provided from its annual parliamentary appropriation are considered by the Company to be owned by Canada and therefore are not recorded as assets on the Company's balance sheet. The Company does not pay for, and has not determined a fair value for, the use of these assets. In our opinion, fixed assets purchased with funds provided by appropriations should be included as assets on the balance sheet and a corresponding amount should be included under parliamentary appropriation in the statement of deficit. The resulting depreciation charges and any related interest charges would have the effect of increasing the net loss for the year.

Certain fixed assets, mainly land and buildings, were paid for by Canada before the Company was established and are still owned by Canada. Non-inclusion of a charge in the statement of operations for the use of such assets further understated the net loss for the year and the deficit at March 31, 1978.

My report to the Minister of Supply and Services on the financial statements of the Company for the year ended March 31, 1978, was qualified accordingly.

20.12 Canadian Broadcasting Corporation - Real property lease not approved by Governor in Council. The Canadian Broadcasting Corporation rents office space in Paris, France, for its European correspondents. In January 1974 the lease was renewed for a period of nine years. The rental price is negotiable and the lease cancellable by the Corporation every three years. Section 41 of the Broadcasting Act stipulates that:

"... the Corporation shall not, without the approval of the Governor in Council, ... enter into a lease or other agreement for the use or occupation of real property involving an expenditure in excess of two hundred and fifty thousand dollars."

Approval of the Governor in Council was not obtained before signing the lease in January 1974 because the minimum expenditure commitment for the first three-year period was less than \$250,000. However, two amendments were subsequently made without obtaining approval:

- In March 1977, the rent was increased to 1.4 million French francs which, converted at the average exchange rate for that month, totalled \$293,000.
- In May 1977, additional space was obtained bringing the total rent remaining for the same three-year period to 1.6 million French francs which, converted at the average exchange rate for that month, equalled \$344,000.

My report to the Corporation and to the Secretary of State of Canada on the Corporation's financial statements for the year ended March 31, 1978, was qualified accordingly.

20.13 Canadian Commercial Corporation - Possible effect on financial position of uncertain outcome of litigation. A contractor began legal action against the Corporation in 1975 as a result of the termination of a portion of a contract. The plaintiff is claiming damages of approximately \$8 million

and the Corporation is contesting the suit. Although legal counsel is of the opinion that the Corporation will be successful, the outcome is still uncertain and any possible adverse effect on the Corporation's financial position will not be known until the litigation has been resolved. As a result of this uncertainty, my report to the Minister of Supply and Services on the Corporation's financial statements for the year ended March 31, 1978, was qualified accordingly.

20.14 Canadian Patents and Development Limited - Inadequacies of the system to verify royalties. The Company makes available to the public, through licensing arrangements, the industrial and intellectual property resulting from publicly-funded research and development. Royalties derived from these licensing arrangements represent the Company's principal source of revenue.

Our 1976 Financial Management and Control Study recommended that the Company arrange for independent audits of licensees' financial returns so this royalty income could be properly validated. Management accepted this decision but the Company's Board of Directors decided that the cost of such audits could not be justified. Since no independent audits were made and since no other formal procedures were applied to check properly on the collection of the royalties due the Company, I was unable to satisfy myself concerning the amount of royalty income earned and reported. My report to the Minister of Industry, Trade and Commerce on the Company's financial statements for the year ended March 31, 1978, was qualified accordingly.

20.15 Defence Production Revolving Fund - Doubtful recovery of a loan. At March 31, 1978, \$1.7 million remained unpaid of a loan of \$3.9 million made in 1972 by the Defence Production Revolving Fund to a contractor providing services to the Canadian Commercial Corporation. Repayment depends on final settlement of the contractor's claim for costs arising from termination of a part of the contract. The Corporation considers that final settlement has been made and that repayment became due on August 4, 1976. The Fund has initiated legal action to recover the loan.

The financial statements of the Fund include the balance of the loan. Because I was unable to satisfy myself as to the collectibility of the loan and because of the uncertainties of the outcome of the legal action, my report to the Minister of Supply and Services on the financial statements of the Fund for the year ended March 31, 1978, was qualified accordingly.

20.16 National Capital Commission - Failure to record depreciation. The Commission charges the entire cost of fixed assets to expense in the year of disposal or retirement rather than providing for annual depreciation on assets susceptible to deterioration and obsolescence over the service period during which they produce revenue or benefit the public. Such assets include all, or portions of, balances representing parkways, bridges and approaches, recreational facilities, property held for development, administration buildings, vehicles, machinery and equipment and office equipment and furniture. My report to the Minister of State for Urban Affairs on the Commission's financial statements was qualified accordingly.

The Commission has referred the matter to the Treasury Board which is coordinating a study of depreciation policy for Crown corporations.

20.17 Supply Revolving Fund - Revenue not recorded. Revenue derived from the negotiation and administration of certain large contracts for the procurement of materiel and services on behalf of departments and agencies is recognized in the accounts of the Supply Revolving Fund evenly over periods of up to 36 months after the contract has been awarded. The costs of these services, including those generated before the contract award, are charged to the accounts as they are incurred. As a

result of this accounting policy, certain revenues are deferred in the Fund's accounts and are not necessarily recognized in the same fiscal period as the related costs.

As a result of this policy, deferred revenue at March 31, 1978, amounted to \$14.6 million and included amounts which should have been recorded as earned during the year. The extent of the overstatement of deferred acquisition contract fee revenue, however, and the corresponding understatement of retained earnings on the balance sheet has not been determined by the Fund.

Because of this failure to properly match revenues and related costs in the same fiscal periods my report to the Minister of Supply and Services on the Fund's accounts for the year ended March 31, 1978, was qualified accordingly.

20.18 Statistics Canada Revolving Fund - Doubtful collectibility of a receivable. The Statistics Canada Revolving Fund was established to finance the costs of statistical services requested by government departments, agencies and others on a cost-recovery basis. In 1976 Statistics Canada agreed to provide certain statistical services to the Department of National Health and Welfare in 1976-77 at an estimated cost of \$308,000, payable in advance. The project was not completed until 1977-78 and the Department has refused to pay for additional costs of \$92,000.

The Fund's balance sheet includes the full amount of the account receivable as an asset with no provision for loss. Because of the uncertainty of collection, my report to the Minister of Industry, Trade and Commerce on the financial statements of the Fund for the year ended March 31, 1978, was qualified accordingly.

20.19 Crown corporations and other entities audited by the Auditor General. Volume III of the Public Accounts contains the financial statements, together with auditor's reports thereon, of agency and proprietary Crown corporations for their fiscal years ended during the year ended March 31, 1978. Of these, I have examined and reported on the following:

- Atlantic Pilotage Authority
- Atomic Energy of Canada Limited
- Canada Deposit Insurance Corporation
- Canadian Arsenal Limited
- Canadian Broadcasting Corporation
- Canadian Commercial Corporation
- Canadian Dairy Commission
- Canadian Film Development Corporation
- Canadian Livestock Feed Board
- Canadian National (West Indies) Steamships, Limited
- Canadian Patents and Development Limited

Canadian Saltfish Corporation Crown Assets Disposal Corporation

Defence Construction (1951) Limited

Eldorado Aviation Limited

Eldorado Nuclear Limited

Export Development Corporation

Farm Credit Corporation

Freshwater Fish Marketing Corporation

Great Lakes Pilotage Authority, Ltd.

Laurentian Pilotage Authority

Loto Canada Inc.

National Battlefields Commission

National Capital Commission

National Harbours Board

Northern Canada Power Commission

Northern Transportation Company Limited

Pacific Pilotage Authority

Royal Canadian Mint

St. Lawrence Seaway Authority Seaway

International Bridge Corporation, Ltd.

Teleglobe Canada

Uranium Canada, Limited

20.20 As mentioned previously, I am required to examine and report separately on a number of other entities which include departmental Crown corporations, revolving funds, agencies, boards, special accounts and corporations which are not Crown corporations. Of these, financial statements for fiscal years ended during the year ended March 31, 1978, together with my reports, appear in Volume II of the Public Accounts under the heading of their related department, for the following:

AGRICULTURE

Agricultural Products Board

Agricultural Stabilization Board

Agriculture Revolving Fund

Canadian Grain Commission

Race Track Supervision Revolving Fund

COMMUNICATIONS

Government Telecommunications Agency Revolving Fund

EMPLOYMENT AND IMMIGRATION

Government Annuities Account

Unemployment Insurance Account

ENVIRONMENT

Fisheries Prices Support Board

EXTERNAL AFFAIRS

International Development Research Centre

Passport Office Revolving Fund

FINANCE

Exchange Fund Account

INDUSTRY, TRADE AND COMMERCE

Standards Council of Canada

Statistics Canada Revolving Fund

NATIONAL HEALTH AND WELFARE

Canada Pension Plan Account

Canada Pension Plan Investment Fund

Medical Research Council

NATIONAL REVENUE

Customs and Excise Revolving Fund

PRIVY COUNCIL

Board of Trustees of the Queen Elizabeth II Canadian

Fund to Aid in Research on the Diseases of Children

Economic Council of Canada

SCIENCE AND TECHNOLOGY

Science Council of Canada

SECRETARY OF STATE OF CANADA

Canada Council Canadian Government Photo Centre Revolving
Fund

National Arts Centre Corporation National Film Board

National Museums of Canada

Public Archives Central Microfilm Unit Revolving Fund

Public Service Commission Staff Development and Training
Revolving Fund

SOLICITOR GENERAL

Royal Canadian Mounted Police (Dependants) Pension Fund

SUPPLY AND SERVICES

Defence Production Revolving Fund

Supply Revolving Fund

TRANSPORT

Airports Revolving Fund

20.21 Other entities on which I report separately include territorial governments and organizations related thereto, international commissions, employee funds and corporations whose financial statements are consolidated with those of their parent Crown corporations. These entities, which are excluded from the Public Accounts, are listed below:

Army Benevolent Fund

Canada Army Welfare Fund

Canadian Broadcasting Corporation Pension Board of Trustees

Canadian Forces Personnel Assistance Fund

Citizens' Repatriation League Incorporated

23rd Commonwealth Parliamentary Conference

Eldorado Pension Plan (1959)

Government of the Northwest Territories

Government of the Yukon Territory

Grimshaw Trucking and Distributing Ltd.

International Commission for the Northwest Atlantic Fisheries

International Fisheries Commissions Pension Society

Northwest Territories Housing Corporation

Northwest Territories Liquor Control System

Northwest Territories Workers' Compensation Board

Parliamentary Restaurant

Pinawa Hospital

Post Office Guarantee Fund

R.C.A.F. Benevolent Fund

R.C.M.P. Benefit Trust Fund

R.C.M.P. Fine Fund

R.C.N. Benevolent Fund

Yukon Housing Corporation

Yukon Liquor Corporation

Yukon Workmen's Compensation Fund

1978 Report of the Auditor General of Canada - Chapter 21

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Observations Reported Under Section 7 of the Auditor General Act</H1>

</CENTER>

<HR>

21.1 Introduction. This Chapter of the Report contains observations disclosed during our examinations that are reported in accordance with Section 7 of the Auditor General Act but have not been included elsewhere in the Report.

21.2 Loss through fraud. A Canadian Broadcasting Corporation employee, supervisor of a regional travel department, misappropriated \$87,500 in more than 200 separate transactions from April 1971 to February 1977.

The employee, by virtue of his position, received Corporation cheques issued for travel advances which were returned to the travel department by the recipients whose trips were cancelled and he also had access to duplicate cheques issued for emergency travel. The employee converted these cheques to his own use and initiated accounting entries to charge the amounts to expense and remove them as accountable items. The fact that he could intercept unused advance cheques, obtain emergency advance cheques and initiate journal entries writing off the advance contributed to the fraud. The Corporation has since issued procedures in that location to strengthen existing controls. The employee was not covered by the Corporation's blanket fidelity bond because of a criminal record arising from a previous embezzlement.

On November 22, 1977, the employee was sentenced to three years in penitentiary for fraud. The Corporation has obtained an order of restitution from the courts in an attempt to recover all or part of the embezzled funds and has demanded reimbursement from the bank for the total amount of the loss for which it is holding the bank responsible.

21.3 Improper charges to a 1977-78 appropriation. In February 1978 the Canadian International Development Agency issued a purchase requisition to the Canadian Wheat Board for approximately 100,000 metric tonnes of wheat at a cost not exceeding \$12 million as supplementary food aid to a developing country.

Under an arrangement between the Agency and the Department of Supply and Services, Winnipeg, the Department pays the invoice value to the Board when a ship is being loaded at a port and then is reimbursed by the Agency. On March 14 and 21, the Department issued cheques totalling \$12 million to the Board. Of this amount \$2.4 million involved a Board invoice covering 19,000 metric tonnes of wheat already loaded. The balance of \$9.6 million was for provisional commercial invoices issued by the Board on March 29, 1978, covering 73,000 metric tonnes of wheat. The invoices stated that the wheat had already been loaded, although actual loading dates for 34,000 metric tonnes was April 27 and for 39,000 metric tonnes, May 6, 1978. Delays in the loading of other vessels had made it impossible for the Board to deliver sufficient grain to the docks before the year-end to meet its commitment to the Agency.

As these shipments were not made until after March 31, 1978, the expenditure is not a proper charge to the 1977-78 appropriations of the Canadian International Development Agency.

21.4 Unnecessary costs resulting from project approval based on inadequate information.

Under a federal-provincial agreement covering flood control measures in the Fraser River Valley, British Columbia entered into a contract in March 1975 for the reconstruction of dykes on the Fraser River, including a new section of dyke that would protect approximately 200 acres of marshland on an Indian reservation and land adjacent to it. Costs of the work were to be shared equally between Canada and the Province.

In June 1975 the Minister of Environment, who represents Canada in the administration of the agreement, requested that work on the new section be halted temporarily to investigate the environmental impact. This portion of the contract was terminated subsequently on the advice of the Fisheries and Marine Service of the Department on the basis that this land constitutes a valuable saltwater marsh. The Province paid the contractor \$568,000 for work already completed on this section.

British Columbia refused to share half of the cost of the terminated work since the project had been approved by various agencies, including the Fisheries and Marine Service, before the contract was awarded. The Federal Government reimbursed the Province for half of the cost in 1976-77 and the balance in 1977-78. Approval of the project was given by the Fisheries and Marine Service without considering the findings of a study relating to the impact of the proposed expansion of the nearby Vancouver International Airport on fisheries resources, which was being done as a part of the overall environmental impact assessment of the proposed airport expansion. Fisheries and Marine Service participated in the study which identified the adverse effect that a consequent reduction of marshland would have on the production of food organisms for salmon. The report of the study was dated shortly before the construction of the new dyke was started.

Because the project was approved on the basis of inadequate information, the Department incurred unnecessary costs of \$568,000. In addition, the Indian Band is demanding compensation from the Department as a result of its action in requesting termination of construction.

21.5 Inadequate accounting and control procedures for the Indian Economic Development Fund.

The Indian Economic Development Fund provides advisory services, grants, contributions, loan guarantees and direct loans to create business and employment opportunities for Indians. Our evaluation of accounting procedures, controls and monitoring for the operations of the Fund confirmed the conclusions already reached by the Department of Indian Affairs and Northern Development that there are serious weaknesses in the administration of the Fund, including the following:

- the role of the Fund and policies for its use are poorly defined;
- review and approval procedures for projects are inadequate;
- timely and effective project monitoring is lacking;
- basic information and financial controls are not maintained over the accounting for loans; and
- satisfactory control procedures and policies relating to loan collateral requirements, recovery action and loan collection have not been established.

Despite these weaknesses in the administration of the Fund, funding continued for many projects that were not viable, resulting in uneconomic use of public funds.

The loan system has recently been computerized to eliminate accounting weaknesses and to provide basic financial and management information. Our review indicates that the new system does not contain reliable financial and management information owing to inadequate procedures in the conversion from a manual to a computerized system and the lack of sound processing controls. For this reason we could not determine the accuracy of the amount of \$52 million recorded as the balance of loans from the Fund at March 31, 1978, or whether an adjustment of \$1.2 million was proper. The adjustment transferred to revenue the interest that was formerly used incorrectly to reduce the principal of loans.

As part of a three-year stabilization program started in 1977-78, the Treasury Board approved \$26 million to liquidate defunct projects, restructure improperly capitalized projects, and support projects which will continue to operate. Supplementary Estimates (A), Appropriation Act No. 3 1977-78, 1977-78, c. 2, provided funds for reducing or deleting the outstanding principal of Indian Economic Development Fund direct loans. The Department used \$4 million of the amount provided for deleting those loans in excess of \$5,000, without obtaining parliamentary authority as required by Section 18 of the Financial Administration Act.

The Public Accounts disclosure of the Development Fund is inadequate since it does not refer to the reduction and deletion of accounts totalling 4 million, proposed similar adjustments in the following two years, and the questionable collectibility of large amounts of arrears of instalments and interest on the loans.

21.6 Lack of authority for compensation payment. In March 1978 the Department of Indian Affairs and Northern Development made payments totalling \$ 1.7 million on behalf of the Naskapi Indians for claims arising from the James Bay Development Project. The payments, representing \$ 1.3 million as cash compensation including interest and \$350,000 as reimbursement of negotiation expenses incurred, were made under the Northeastern Quebec Agreement. The payments were not legally made as the Agreement did not come into effect until April 1978.

Section 4 of the James Bay and Northern Quebec Native Claims Settlement Act, 1976-77, c. 32, makes provision for the Governor in Council to approve by Order an agreement with the Naskapi Indians covering native claims, rights, titles and interests. Section 5 of the Act stipulates that the agreement comes into effect on the thirtieth sitting day after it has been laid before Parliament unless a motion to revoke the Order is presented to the Speaker of the House of Commons or the Senate. Since the Order was tabled in the House on March 2, 1978, and in the Senate on March 7, 1978, it would have come into effect automatically on the thirtieth sitting day, April 27, 1978, if not revoked. In fact, a motion in the Senate to revoke was defeated on April 14, 1978, which brought the Order into effect on that date in accordance with the provisions of the Act. In any case, the payments were made in the latter part of March before the Agreement came into effect and, therefore, they were made without authority. The date of payment also preceded the last day for payment provided in the Agreement which stipulated that the payments were to be made within two months of the approval of the Agreement, an effective date of April 7, 1978, following approval by the Minister on February 7, 1978.

21.7 Unbilled revenue. The Department of Public Works administers a number of commercial leases, including those for tenants located in expropriated buildings in Ottawa. Many contain escalation clauses requiring the tenant to pay a proportionate share of increases in the cost of operating and maintaining the buildings throughout the term of the lease.

Our audit disclosed that the Department had not billed tenants subject to escalation for cost increases in 1975, 1976 and 1977. Although the Department subsequently billed \$267,000 for 1976

and 1977, it was unable to bill tenants for their share of cost increases for 1975 since it did not obtain proper operating and maintenance data for certain buildings at the time of expropriation.

21.8 Questionable aspects of investment in jointly-owned and controlled company. The terms of a 1972 agreement between Canada, as represented by the Minister of Regional Economic Expansion, and the Province of Nova Scotia, as represented by the Minister of Development, provided for the joint ownership of a company to carry on business investment operations in Nova Scotia and agreed that both governments would invest a total of \$20 million in Mainland Investments Limited (previously called Metropolitan Area Growth Investments Limited). During the year ended March 31, 1973, Canada paid its full contribution of \$5 million and advanced at that time a further \$5 million to the Province to enable Nova Scotia to make its initial investment. The Province undertook to pay the remaining \$10 million of its subscription in quarterly instalments of \$500,000 each, with the final payment on January 1, 1978.

Although the Company was incorporated in March 1973, it did not become operational until late in 1975 with the President being appointed on September 10 of that year. To March 31, 1976, more than three years after the Federal Government had made its contribution, the Company had not made any investments to stimulate the employment of people and resources in Nova Scotia, as it was incorporated to do and in fact at that time had \$16 million invested in securities of a short-term nature.

The Province had paid eight of the 20 instalments the agreement called for at March 31, 1978. While acknowledging its outstanding commitment for \$6 million, it decided to defer payment of the remaining 12 instalments since the Company was not in need of additional funding as it still had \$10 million invested in short-term securities. The Province has sought the Department of Regional Economic Expansion's agreement to an amendment which would confirm the deferment. An amendment has not yet been finalized.

The most significant asset of the Company at March 31, 1978, apart from the short-term investments, was a first mortgage loan with a recorded value of \$4 million, secured by a cruise ship and equivalent to its appraised value. The mortgager had defaulted on his obligations and the Company took possession of the vessel. This has resulted in legal action against the Company by the promoters of the project. The Company believes that it has good defence to the action and valid legal grounds for its counter-claims against the applicants. Since it is not possible to determine the realizable value of the first mortgage loan or the outcome of the litigation, the auditors' report on the financial statements for the year ended March 31, 1978, was qualified accordingly. The notes to the financial statements disclosed that unspecified additional costs relating to the vessel would be incurred until the vessel is sold and also at the time of sale.

The annual report of the Directors of the Company addressed to the appropriate Ministers recommended that the Company be wound up since they felt its performance had left much to be desired and they questioned the need for that particular type of organization and its potential viability. This resulted in suspension of the Company's operations for a period during which its role will be evaluated.

In view of these questionable aspects, the status of Canada's investment of \$5 million in the Company is uncertain.

21.9 Unproductive expenditure in developing and producing a new coin. Since the cost of producing the one-cent coin had risen above its face value, the Royal Canadian Mint undertook in 1976 to develop a new one which would cost less. The Mint subsequently made a recommendation, which

the Government approved in August 1977, to introduce a smaller one-cent coin effective January 1, 1978.

A number of private and publicly operated businesses protested the decision. They argued that it would cost substantial amounts to change coin-selector equipment and token-operated devices and also that there was not time enough to make these mechanical changes in an orderly fashion. As a result, on the Mint's advice, the Government reversed its decision in December 1977, and cancelled the new coin issue.

In preparation for the issue, the Mint had accumulated inventories and incurred development and production expenses. As a result of the cancellation, these expenses were written off and the inventories were reworked at a total cost of \$230,000.

21.10 Provision of meals to employees without charge. Since January 1935 the Canadian Penitentiary Service, under the authority of a Commissioner's directive dated December 18, 1934, has provided without charge a duty meal to penitentiary officers required to remain within the institution over the noon hour. However, in recent years we understand that these officers have been allowed to leave the institution at lunch time unless specifically designated to remain on duty then. We have found no evidence that the directive was either amended or rescinded. Based on information provided by the Department for 1977-78, a total of 1,077,000 noon meals were provided without charge by institutions to correctional and living unit officers on duty over the noon meal period and to other penitentiary staff.

In October 1974 the Department sought advice from the Department of National Revenue as to whether noon meals provided free to certain employees should be considered as a benefit for the purposes of the Income Tax Act. The Department of National Revenue replied in January 1975 that free noon meals are a benefit to be included in income but that there would be no taxable benefit if the employees were required to pay for the meals at a price equal to the direct cost of the food. The Canadian Penitentiary Service informs us that a decision has not been taken on this matter. As a consequence, it is not reporting any taxable benefit for meals provided to employees without charge, which cost an estimated \$1.6 million in 1977-78.

The Department is currently reviewing its institutional policy on duty and non-duty meals and its impact on the question of taxable benefits.

21.11 Misuse of working capital advances. Solicitor General Vote L16b Appropriation Act No. 2, 1973, 1973-74, c. 4, authorized the establishment of an Operational Stores Working Capital Advance by the Canadian Penitentiary Service to finance the acquisition of operational stores. The amount outstanding at any time is not to exceed \$5 million. The Service also operates a revolving fund, authorized by Justice Vote 543, Appropriation Act No. 3, 1953, 1952-53, c. 54, to finance the operation of canteens in Federal Penitentiaries. The amount outstanding at any time is not to exceed \$255,000. The Department's Financial Manual says that the Operational Stores Account is not to be used to finance canteen purchases.

During the year ended March 31, 1978, the Operational Stores Account was improperly used to finance the acquisition of canteen supplies. It was charged with purchases costing \$642,000 and credited with \$639,000 for supplies transferred to the Canteen Account. The balance of the Operational Stores Account at the year-end was \$4,952,000, including \$49,000 for inventories of canteen supplies.

Canteen supplies charged to the Canteen Account during the year amounted to \$1,950,000, including the \$639,000 transferred from the Operational Stores Account. The balance of the Account at

the year-end was \$229,000 excluding the canteen supplies inventories of \$49,000 in the Operational Stores Account. Had these inventories been charged to the Canteen Account, its balance at the year-end would have been \$278,000, or \$23,000 over the authorized limit. For nine months of the year the Canteen Account's authorized limit had been exceeded by amounts ranging from \$21,000 to \$158,000 without taking into consideration any inventories of canteen supplies being financed through the Operational Stores Account.

The Department informs us that it is requesting a Treasury Board approval to include an item in Supplementary Estimates increasing the authorized limit of the Canteen Revolving Fund.

1978 Report of the Auditor General of Canada - Chapter 22

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>Observations on Matters Dealt with in Previous Years' Reports</H1>

</CENTER>

<HR>

22.1 Introduction. The Audit Office encourages government departments, agencies and Crown corporations to take prompt remedial actions on deficiencies and irregularities disclosed by our examinations. For this purpose we maintain constant liaison with the officials concerned and monitor their progress in implementing corrective action. Where appropriate action has not been taken on matters arising from our audits and disclosed in previous Reports, we advise the House of Commons in this Chapter of the Report together with the reasons given by the officials concerned.

22.2 Reports of the Treasury Board Secretariat and the Comptroller General of Canada. My 1977 Report (paragraph 18.2) stated that the Secretary of the Treasury Board had advised the Chairman of the Standing Committee on Public Accounts of the actions reported by departments and Crown corporations on all except 15 of the matters raised in Parts 6 to 19 of my 1976 Report. On July 11, 1978, the Comptroller General of Canada advised the Chairman of the Committee on the action taken on 10 of the outstanding items and stated that he was actively pursuing the remaining five:

<u>Paragraph Number</u>	<u>Title</u>
9.6	Office accommodation - System of accounting for costs of accommodation.
13.12	Grants and contributions - External Affairs - Parliamentary control over assessed contributions.
16.11	Company of Young Canadians - Severance payments to volunteer members.
18.5	Land rental paid under long-term lease for property not being occupied.
19.6	Income tax owing by non-residents.

The Comptroller General's letter is reproduced in Appendix F to this Report.

22.3 On June 30, 1978, the Comptroller General advised the Chairman of the Standing Committee on Public Accounts of the action reported to the Treasury Board Secretariat as having been taken by departments and Crown corporations on matters raised in Parts 10 to 17 of my 1977 Report. This letter is included in Appendix F to this Report. Action has yet to be reported on the following matters:

<u>Paragraph Number</u>	<u>Title</u>
-------------------------	--------------

10.21	Use of statistical data in determining certain government expenditure. Travel and relocation expenses in Crown corporations:
11.6	- Travel advances
11.7	- Transportation expenses
11.8	- Accommodation and living expenses
11.9	- Expenses related to extended travel
11.10	- Relocation expenses
11.11	- Internal financial controls
11.19	Central Travel Service - Billing systems and procedures. Grants and contributions:
12.13	- Disclosure in the Estimates and Public Accounts
12.14	- Grant to one research institute
14.4	Loans likely to require parliamentary approval for write off.
14.9	Valuation of pension accounts.
15.17	Supply Revolving Fund - Revenue not recorded.
15.19	Failure to accrue employee termination benefits.
16.5	Payment improperly charged to a 1976-77 appropriation.
16.8	Improper payment under an incentive agreement.

22.4 These reports to the Standing Committee on Public Accounts from the Treasury board Secretariat and the Comptroller General of Canada greatly assist the Committee and my Office in following up and monitoring action the Government has taken on matters raised in my Reports.

Oil Import Compensation Program

22.5 **Introduction.** In 1974, at the request of the Governor in Council, we undertook a continuing inquiry into the administration of expenditures of the Oil Import Compensation Program under Section 62 of the Financial Administration Act.

The program was administered by the Department of Energy, Mines and Resources until October 31, 1974, and thereafter by the Energy Supplies Allocation Board which reports to the Minister of Energy, Mines and Resources.

Under the Program, importers of crude oil and petroleum products are compensated so as to cushion the Canadian economy from the impact of the large and rapid increases in the price of imported crude oil used in Canada.

A summary of appropriations and expenditures for the five years to March 31, 1978 are as follows:

<u>Fiscal year</u>	<u>Appropriation</u> (000)	<u>Expenditures</u> (000)
1973-74	\$ 240,000	\$ 157,000
1974-75	1,165,000	1,162,000
1975-76	1,685,000	1,582,000
1976-77	1,410,000	945,000
1977-78	<u>925,000</u>	<u>925,000</u>
	<u>\$ 5,425,000</u>	<u>\$ 4,771,000</u>

For the year ended March 31, 1978, the total volume of imported foreign crude oil decreased by 14% to approximately 196 million barrels. The basic rate of compensation per barrel decreased by 24% from \$3.90 to \$2.95 assuming that the U.S. and Canadian dollars are at par. As oil imports are paid for in U.S. dollars the rate of compensation is adjusted to reflect the exchange value of the Canadian dollar vis-à-vis the U.S. dollar each time a claim for compensation is paid. As a result the decreases in volumes compensated and in the basic rate of compensation were almost offset by the increase in exchange rate adjustments of approximately \$1.25 per barrel so that there was little change in total expenditures over the previous year.

In my last Report it was noted that all compensation payments for cargoes loaded before July 1, 1975, were on a provisional basis until the effect of the host government participation on the November 30, 1973, base-date costs had been assessed. As a result Program staff had to conduct studies to ensure that claimants' costs had been adjusted to include retroactive host government participation costs, i.e., those costs determined to have been paid to the governments of producing countries for their participation in the ownership of the oil producing companies. These studies were completed during the year ended March 31, 1978, and the process of finalizing the relevant provisional claims has commenced and is expected to be completed during the 1978-79 fiscal year.

The following significant items have come to our attention during the course of our examination.

22.6 Special freight compensation for cargoes lightened in the Caribbean en route to Canada.
In my previous Report it was noted that \$3.8 million of excessive freight compensation paid to oil

importers on cargoes transshipped in the Caribbean remained to be recovered. Since then a recovery of \$1.6 million has been made from one oil importer. This importer has initiated legal action against the Energy Supplies Allocation Board for the return of the \$1.6 million.

The Board has decided to delay recovery of the remaining \$2.2 million pending the outcome of the above-mentioned action.

22.7 Legal action for the reversal of a Board decision. Bunker fuel oil sold by oil importers for use by foreign registered flag vessels involved in the coasting trade of Canada was originally classified as "Exports" and therefore was to be deducted from compensatory crude. On March 12, 1975, the Petroleum Import Cost Compensation Regulations were amended so as to reclassify this bunker fuel oil as "Non-exports" and therefore no longer deductible from compensatory crude. Prior to the above amendment, an oil importer had failed to deduct such bunker fuel oil in its compensation payment calculations. The Board therefore deducted the sum of \$2,005,013 from the claims submitted to correct for this omission.

The importer applied to the Board to have the amended Regulation applied retroactively to the commencement of the import compensation program. The Board denied this request and as a result, the importer has initiated legal action in the Federal Court of Canada for the review and reversal of this Board decision.

22.8 Authorization of interest payments. Host governments charged interest on the retroactive aspects of their participation in the ownership of the oil producing companies who in turn may have passed it on to Canadian oil importers. During 1977-78 two importers included approximately \$3.1 million of such interest in their compensation claim calculations which were subsequently paid by the Energy Supplies Allocation Board. We were unable to obtain adequate documentation to support the authority to pay such interest.

22.9 Audit scope. The Energy Supplies Allocation Board, by virtue of its policy and Program regulations, has recognized the need to have audits made of all claims submitted for compensation. Accordingly the Board has engaged independent auditors, generally the claimant company shareholders' auditor, to conduct specific examinations on the authenticity of claims and on the validity of supporting information. To a much lesser extent the Board conducts its own audits of claims of certain importers.

We have examined all such external auditors' reports received by the Energy Supplies Allocation Board up to June 19, 1978. Still to be reported on by the independent auditors are claims totalling \$1,447 million as per the following schedule.

<u>Year</u>	<u>Total Value of Claims</u>	<u>Percentage not Audited</u>
1975-76	\$ 109 million	7%
1976-77	413 "	44%
1977-78	925 "	100%
	\$ 1,447 million	

In addition, no audits have been performed on those companies audited by the Energy Supplies Allocation Board staff since April 1977.

In our opinion, subject to the audit of the compensation payments referred to in the preceding paragraphs disclosing no significant discrepancies, and subject to the matters referred to above in connection with:

- special freight compensation for cargoes lightened in the Caribbean en route to Canada,
- legal action for the reversal of a Board decision, and
- authorization of interest payment,

payments in the fiscal year ended March 31, 1978, have been properly processed and are in conformity with applicable legislation, regulations and guidelines.

22.10 Audit of price restraint. Since commencement of the Oil Import Compensation Program on January 1, 1974, eligible importers of foreign crude have been required to maintain prices of products derived from crude at those levels existing at the end of 1973 except for those increases in selling prices authorized by the Minister from time to time which resulted from rising non-crude costs and from the decrease in the rate of compensation that followed the allowed increases in western Canadian crude oil prices.

The Energy Supplies Allocation Board has been monitoring the price behaviour of the oil companies. In addition to our work in the initial collection and examination of data at the oil companies, we have audited the data collected by the Board from September 1974 to March 31, 1978, and are satisfied that price levels during this period did not exceed price levels prevailing in January 1974 adjusted for allowable cost increases.

Oil companies have been subject to Anti-Inflation Board price and profit guidelines since October 14, 1975. The Energy Supplies Allocation Board has supervised the monitoring of the oil industry's compliance with these guidelines on behalf of the Anti-Inflation Board.

* * * *

22.11 Land rental paid under long-term lease for property not being occupied. Previous Reports (paragraph 18.4 in 1977) described the circumstances under which the Department of the Environment entered into a 71-year lease in 1974 for a 55-acre tract of land in Greater Vancouver as the site for the Pacific Environment Centre. Construction was deferred because of budgetary restraints. In May 1976 the land was declared to be in excess of Crown requirements and negotiations began with the owner concerning acceptable alternative uses.

An alternative use has not yet been found and the Department continues to pay an annual rental of \$241,400. Additionally, during the year the Department paid \$112,000 in municipal taxes for the years 1975 to 1977.

22.12 Weaknesses in the administration of the Fisheries Prices Support Board. Previous Reports (paragraph 18.6 in 1977) referred to various weaknesses in the administration of the Fisheries

Prices Support Board. To overcome these weaknesses, the Board stated that it was preparing procedures on purchases and deficiency payments to be implemented in 1977-78 and that it was arranging for an audit of producers' records to validate claims.

Many of the weaknesses have since been corrected. However, the Board did not meet its objective of implementing detailed procedures in 1977-78 for establishing prices at which sales and purchases were to be made and the rate at which deficiency payments were to take effect. As a consequence, there was no evidence that the prices at which the Board's transactions took place were set in accordance with a stated Board policy. At the time of our audit a preliminary draft of these procedures had been prepared but not yet presented to the Board.

Similarly, because of the lack of approved procedures, we were unable to satisfy ourselves regarding the selection of suppliers. Although no evidence of questionable payments was found, significant purchases were made from suppliers with which two Board members were associated. Draft conflict-of-interest guidelines have been prepared but not yet approved by the Board.

We reported in our 1976 and 1977 Reports that audits of producers' records to validate their deficiency payment claims had not been undertaken. Since then three audits were completed in the year ended March 31, 1978. One indicated that claims of \$81,000 were fairly presented; another disclosed that claims aggregating \$400,000 were overstated by \$40,000; the third concluded that an opinion could not be expressed on the \$420,000 amount claimed. The overstated amount has been recovered and we are advised that action has been taken to correct the deficiencies identified in the third audit report.

22.13 Inadequate accounting and control procedures in the Indian Arts and Crafts Central Marketing Service Revolving Fund. My 1977 Report (paragraph 18.7) drew attention to continuing major deficiencies in the accounting and control procedures for the Indian Arts and Crafts Central Marketing Service Revolving Fund, even though the Department of Indian Affairs and Northern Development had entered into an agreement with an outside company to reorganize and manage its operations. In addition, the operation of the Fund did not comply with certain legislative and regulatory requirements. As a result, an opinion on the financial statements for the year ended March 31, 1977, was not provided.

Our examination of the Fund for the year ended March 31, 1978, disclosed that many deficiencies still exist:

- The accounting records the management company maintained for the operating section of the Fund, known as the Canadian Indian Marketing Service, were not segregated from its own records and were not reconciled regularly with the Fund control account.
- Accounting controls for inventory and security procedures were still inadequate.
- The management company financed by means of bank overdrafts, which effectively bypassed the controls inherent in the accountable advance system provided for in the agreement.
- The company continued to exceed its delegated authority of \$10,000 for individual expenditures and to make expenditures which were neither authorized by the Minister under Section 27 of the Financial Administration Act nor approved by the Treasury Board as stipulated in the Government Contracts Regulations.

- Advances to suppliers continued to be paid before receipt of goods, without appropriate contractual authority, contrary to Section 27 of the Financial Administration Act.

The failure of the management company to obtain adequate authority and the lack of monitoring by the Department are illustrated by the following transaction covering the purchase of calendars for resale and their subsequent conversion to matted pictures. The transaction also raises questions as to whether due regard was given to economy:

- In the early part of 1976-77 the management company purchased 1977 calendars at a cost of \$33,000. These calendars did not sell well and during the latter part of the year, in an effort to recover the loss on the remaining inventory, but without the benefit of market research, a contract was entered into for disassembling, cutting and matting certain of the pictures on the calendars at an additional cost of \$173,000, most of which was paid during 1977-78. Both of the above transactions exceeded the authority granted to the management company.
- The pictures proved to be not a popular sales item and the remaining inventory of approximately \$200,000 was written off during 1977-78.

There are significant discrepancies between the financial statements of the Canadian Indian Marketing Service, prepared by the management company for the year ended March 31, 1978, which represents the bulk of the transactions of the Fund, and the financial statements of the Fund appearing in the 1978 Public Accounts. Furthermore, the firm of public accountants that performed the audit of the Canadian Indian Marketing Service declined to express an opinion on the financial statements for the year ended March 31, 1978, because of their inability to verify certain accounts receivable transactions and to satisfy themselves concerning the opening balances at the beginning of the year.

Based on the above, together with the fact that we were unable to obtain from the Department essential information relating to the final consolidation of the transactions of the Canadian Indian Marketing Service with those in the Department's control account for the Fund, we are again unable to determine whether or not we would be able to express an opinion on any financial statements of the Fund for the year ended March 31, 1978.

The Revolving Fund has suffered large annual losses and has not operated on a self-sustaining basis. As a result, the Treasury Board has directed that the operations of the Revolving Fund be terminated as quickly as possible and not later than December 31, 1978.

22.14 Inadequate accounting for contributions to bands. The Department of Indian Affairs and Northern Development has for some years been transferring to Indian bands responsibility for managing public funds provided for various band programs. A condition of the transfer is that the bands provide the Department with yearly audited financial statements, to ensure an adequate accounting for the funds and to provide a basis for departmental monitoring and evaluation of expenditures. For the last 10 years (paragraph 18.8 in our 1977 Report), reference has been made to inadequacies in the accounting for funds administered by Indian bands.

In view of the following weaknesses, the continued transfer of funds to bands who have not properly accounted for them represents a major weakness in the ability of the Department to provide an accounting to Parliament:

- Agreements with Indian bands for the management of funds frequently do not require them to provide information needed by the Department to ensure proper use of the funds.
- In many cases audit reports on financial statements are not received on a timely basis. This deficiency and the lack of standardized procedures and defined responsibility for regular monitoring of band administration have resulted in the transfer of additional funds before there is an adequate accounting for previous funding.
- A significant number of audit opinions on the Indian band financial statements are continually either qualified or denied with respect to important matters, due primarily to non-existent or poor accounting systems and the lack of trained financial and administrative staff. Although departmental policy states that control will revert back to the Department where a band has demonstrated it is not capable of proper financial administration, this policy is not being followed.
- The terms of reference for the audit of Indian bands are not adequately developed to meet the needs of the Department. The audits of Indian bands are now directed towards expressing an opinion on the fairness of the financial position and results of operations. The auditors are not required to report on whether funds have been used for intended purposes or in accordance with regulations.
- Monitoring and evaluation of Indian band administration of public funds lacks adequate procedures and is performed by staff lacking independence. The scope of the existing monitoring procedures is largely a review of year-end Indian band financial statements and reconciliation of them with departmental records. The function is performed by the band financial advisers whose primary responsibilities are to advise the bands and help them administer the transferred funds.
- Regional and Headquarters monitoring of the existing procedures has been inadequate to provide the Department with an accounting for public funds.

22.15 Acquisition of Radio Engineering Products Limited as satisfaction for debts due to the Crown. Our 1972 Report (paragraph 101) described the events which culminated in the acquisition of Radio Engineering Products Limited in July 1972 as satisfaction for debts of \$4.3 million due to the Crown. The Company was to be sold at the earliest opportunity. The Standing Committee on Public Accounts, in its Second Report to the House of Commons dated March 6, 1975, requested the Auditor General to inform the House of developments.

A buyer for the Company was not found and our 1976 Report (paragraph 19.5) reported that the Company had filed a voluntary declaration of bankruptcy on November 27, 1975. At that time the indebtedness to the Crown had increased to \$6 million.

The Trustee in Bankruptcy has informed us that he had \$418,000 on deposit at March 31, 1978, and that the indebtedness to the Crown was still outstanding.

22.16 Improper advance payments for film productions. The National Film Act, *R.S., c. N-7*, requires government departments and agencies to procure films and related services through the National Film Board. The work may be undertaken directly by the Board or by private film producers under contract with the Board.

The Board follows the practice of billing all or part of its services in advance, often at the request of its government customer. At March 31, 1978, the Board had invoiced approximately \$1,112,000 to 25 departments and agencies for work yet to be done or for which payments to sub-contractors were not yet due. The total amount billed in advance was charged against the 1977-78 and prior year's appropriations of the various departments and agencies concerned. Of the amount billed in advance, \$181,000 had been billed before March 31, 1977.

The Financial Administration Act, Sections 20 and 27, stipulates that payments for services which had not been performed before the fiscal year-end are improper charges to appropriations of that year. If the amounts had not been pre-billed, portions of the appropriations of the departments and agencies concerned would have lapsed in accordance with Section 30 of the Act, rather than being charged with prepayments to the National Film Board.

Similar pre-billing practices of the Board were reported in paragraph 65 of my 1973 Report. Although the amounts of pre-billings have declined significantly since then, the continued substantial billing of work in advance and resulting prepayments are contrary to the provisions of the Financial Administration Act and weaken parliamentary control.

22.17 Delays in issuing assessments and inadequate liaison between divisions of the Department of National Revenue - Taxation resulting in loss of revenue to the Crown. After reviewing certain investigations by the Special Investigations Division of the Department of National Revenue (Taxation) and subsequent income tax assessment increases that resulted, we reported in paragraph 61 of our 1974 Report that revenue was being lost to the Crown as a result of delays in issuing assessments and of inadequate liaison with other divisions of the Department. We recommended that procedures and policies on issue of assessments and seizure of assets be reviewed and, if necessary, legislative changes sought to preclude the transfer of taxpayers' assets beyond the reach of the Department. The Department advised us that steps were being taken to strengthen liaison between divisions and that legislative changes were under consideration. Our examination indicated that liaison had improved substantially since our review.

The Standing Committee on Public Accounts, in its Fourth Report 1975, recommended that the Department take immediate action to eliminate such losses and that, if necessary, the Minister of Finance move swiftly to introduce legislation. The Committee also recommended, where appropriate, full public disclosure of names and facts of cases written off. (See also paragraph 22.18 of this Report.)

In August 1975 the Department submitted the proposed legislative amendments to the Department of Finance. The proposals were not favourably received and have not been incorporated into legislation. Unless the Income Tax Act, *R.S., c. I-5*, is amended the public disclosure of the names and facts of income tax liabilities written off would be a violation of its confidentiality provisions.

22.18 Income owing by non-residents. Since 1967 our Reports (paragraph 19.6 in 1976) have drawn attention to the deletion annually from the Accounts of Canada of substantial amounts of income tax that could not be collected because the taxpayers were no longer resident in the country.

During 1977-78 these deletions amounted to \$3.8 million owed by 1,300 taxpayers.

The Standing Committee on Public Accounts, in its Second Report dated March 6, 1975, recommended that consideration be given to publishing the names of all taxpayers' whose accounts are written off. An interdepartmental committee of Deputy Ministers from the Departments of Justice,

National Revenue (Taxation) and Finance studied the question of confidentiality of tax information, including the possibility of publishing the names, and reported in 1976 to the three Ministers concerned.

We were informed on June 9, 1978, that no action was taken after the Committee report was presented to the ministerial level because agreements could not be reached, and the report is now dormant.

The recommendation of the Standing Committee is, therefore, still outstanding. Furthermore the Department of National Revenue believes that in addition to violating the present confidentiality provisions of the Income Tax Act, the publishing of the names of former residents of Canada who were delinquent in the payment of taxes was not considered as an effective way to influence persons now resident in foreign countries.

22.19 Working capital advance exceeded. Post Office Vote 541, Appropriation Act No. 4, 1954, 1953-54, c. 67, established the Post Office Working Capital Advance for acquiring and managing material to be used in manufacturing uniforms, satchels and mailbags. Paragraph 17.6 of our 1976 Report noted that the Department had exceeded the advance limit of \$1.5 million each month by amounts ranging from \$700,000 in December 1975 to \$62,000 at March 31, 1976, and that the Treasury Board had approved an increase in the authorized limit from \$1.5 million to \$3 million, subject to a Supplementary Estimate being sought.

Post Office Vote L7b, Appropriation Act No. 5, 1976, 1976-77, c. 2, increased the authorized limit to \$3 million. However, in 1977-78 the Department exceeded this limit during five consecutive months in amounts ranging from \$340,000 to \$960,000.

The underlying problem is the length of time between negotiation and completion of contracts, which in the case of the larger ones can often extend beyond 12 months. Moreover, delivery dates specified in contracts are not always met.

The Department is taking steps to reduce the contracting period and to institute an improved financial control and reporting system.

22.20 Penitentiary staff overtime. Paragraph 206 of our 1972 Report noted that the cost of overtime paid to the Canadian Penitentiary Service employees rose sharply to \$3.7 million in 1971-72. Of this, \$2.9 million (78%) covered 603,000 overtime hours worked by custodial staff. The Department was studying the causes and possible corrective measures.

Since 1972 overtime cost has continued to increase, reaching an all-time high of \$16.2 million in 1977-78. Of this, \$13 million (80%) covered 1,058,000 overtime hours for custodial staff, a decrease in hours, 96,000 less than in 1976-77, but not in cost. An analysis shows the following reasons for overtime work by custodial staff:

	<u>Overtime hours</u>
Work on statutory holidays	302,000
Replacement of other officers during absences, including 222,000 hours for sick leave replacement	362,000

Special or urgent duty	135,000
Vacant positions	92,000
Other reasons	<u>167,000</u>
	<u>1,058,000</u>

Departmental studies, the most recent dated August 1974, identified a number of problem areas giving rise to overtime. These included disturbances in penitentiaries, demands for additional security, delays in staffing vacant positions, deficiencies in planning and using human resources and in the overtime reporting system, overtime budgets prepared without regard to actual experience and minimal guidance by Headquarters and regional staff in implementing controls on overtime. Recommendations on improving the control of overtime included the establishment of overtime review committees in each institution, assigning responsibility at all levels of management for authorizing, controlling and monitoring overtime and implementing a suitable reporting system to provide managers with information adequate for analysing overtime use and taking corrective action where indicated.

The Treasury Board Secretariat in February 1978 expressed concern about the substantial increase in overtime hours in spite of growth in manpower resources and a much lower rate of inmate population growth. In response the Department advised the Secretariat in August 1978 of its plans and of actions already taken. These actions included establishing an overtime committee in Headquarters and assigning responsibility to a person at Headquarters to control overtime by auditing institutions with the greatest amount, reviewing reporting systems and analysing factors affecting it. Consultations with regional staff were proceeding with a view to achieving an 18% reduction in overtime hours for 1978-79 and regional directors were receiving information by institutions on overtime hours worked and quarterly reports on progress in meeting departmental goals.

22.21 Inadequate control of payrolls. The Central and Regional Pay Systems of the Government of Canada cover some 330,000 employees, of whom approximately 50% are paid from Ottawa. These systems account for payroll costs of about \$6,000 million annually.

The individual departments are responsible for preparing and authorizing pay-input documents covering all information affecting employees' pay, and the Department of Supply and Services uses this data to produce pay cheques, paylists and related accounting information for the departments and the Accounts of Canada.

Over the past three years our Office has carried out a number of studies of payroll systems directed primarily to the adequacy of internal control over payroll transactions. On the basis of these studies, our 1975 Report recommended a study to determine how departments could control documentation better (paragraphs 10.27 and 10.29 of the Report, and 5.25 to 5.38 and 6.23 to 6.27 of the Supplement). Our 1976 Report (paragraphs 11.1 and 11.2) reported weaknesses in internal control in payroll systems and our 1977 Report (paragraphs 6.38 to 6.44) reported control deficiencies in the Central and Regional Pay Systems of the Department of Supply and Services. Paragraphs 10.68 to 10.80 of this Report contain a follow up on the observations in the 1977 Report.

Our studies indicated the need for more effective controls in payroll operations and, particularly, to ensure that departments are made more clearly aware of their responsibilities for the completeness

and accuracy of pay-input and -output information. Furthermore, the studies showed that the Department of Supply and Services needs to attune itself more effectively to departmental needs and that the Treasury Board should assume a more active co-ordinating role between the individual departments and the Department of Supply and Services.

Our review of payroll systems during the current year disclosed that departments have not improved controls over their payrolls significantly.

A pilot examination of the Regional Pay System and the related departmental payroll procedures was carried out to determine whether the identified control weaknesses could affect the accuracy of pay transactions. Although the pilot examination did not constitute a full audit of payroll, it indicated that improvements can and should be made to control the payroll system more effectively. In conducting the pilot examination we encountered the following problems:

- Procedures did not provide for:
 - the adequate balancing by departments of responsibility centre paylists with their related Financial Reporting System statements;
 - the adequate reconciliation of pay information with T4 (Income Tax) information by the Department of Supply and Services; and
 - the controls necessary to balance payroll data accumulated by the Compensation Services Branch with the same data accumulated by the Government of Canada Accounting Branch, both Branches of the Department of Supply and Services. Projects have been developed to improve the interface between the systems of the two Branches.
- Because of limitations in the present computer systems design the Department of Supply and Services encountered difficulty in providing us with payroll data and in determining details and explanations for certain information on payroll files. As a result we were unable to balance the various payroll master and history files.

The foregoing indicates deficiencies in the documentation of the payroll system and in its internal controls.

On July 28, 1977, the Treasury Board released a policy circular on pay administration stating that:

- pay is primarily a departmental responsibility;
- pay must be administered within the constraints of policy and procedures will be simplified;
- the data processing aspects of pay administration will be handled by an upgraded Department of Supply and Services pay system more closely attuned to departmental needs; and
- departments must be prepared to accept the accountability which accompanies the delegation of responsibility and authority for pay administration.

This policy circular also identifies standards and defines the responsibilities of the Treasury Board Secretariat, the Department of Supply and Services and user departments for payroll. The phased implementation of this division of responsibilities is expected to commence April 1, 1979.

Action continues to be taken and is planned by the Department of Supply and Services to enhance the payroll system and to attune it more effectively to departmental needs. Action is also being taken by the Treasury Board Secretariat to assist in the implementation of its policy circular.

Because of the control deficiencies in payroll systems that our reviews have disclosed during the last four years, more extensive tests of payroll transactions will be made during the coming year to assess the corrective action taken.

22.22 Cost of unused accommodation. Previous Reports (paragraph 17.7, 1977; paragraph 8.14, 1975, paragraph 64, 1974, paragraph 110, 1973, etc.) have referred to paying rent for unused accommodation. During 1977-78 we again noted instances where a department and a Crown corporation were paying for unused rental accommodation:

Montreal, Quebec. In April 1964 the Department of Public Works entered into a 20-year lease with the Canadian National Railways Company for the major part of an office building to provide accommodation for the International Civil Aviation Organization. In July 1975 the Organization vacated the premises with nine years remaining on the lease.

The Crown has been negotiating with the landlord either to sublet the property or obtain a quit-lease. To date negotiations have not been successful.

For 1977-78 the net cost of operating these unoccupied premises amounts to \$746,000.

Toronto, Ontario. The Canadian Broadcasting Corporation entered into a lease agreement in October 1976, effective January 1, 1977, for office facilities in Toronto. It was management's intention to use the premises to house the computer facilities and provide office accommodation for its legal department. The Corporation was given the opportunity to occupy the premises free of rent from October 1 to December 31, 1976, for renovation purposes.

Subsequent to the signing of the lease, management requested a study by the Corporation engineers. As a result it was determined that it would be too costly to install computer facilities in the premises. Consequently, except for occasional and temporary use, the Corporation did not occupy the premises on a permanent basis until March 1978. Including the three rent-free months, the premises were virtually empty and available to the Corporation for approximately 17 months.

Based on the annual rental of \$74,000, effective January 1, 1977, reduced by an allowance of \$10,000 for leasehold improvements, the Corporation incurred costs of at least \$77,000 before permanently occupying the premises.

1978 Report of the Auditor General of Canada – Appendix A

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX A</H1>

</CENTER>

<HR>

AUDITOR GENERAL ACT

25-26 ELIZABETH II

CHAPTER 34

An Act respecting the office of the Auditor

General of Canada and matters related

or incidental thereto

[Assented to 14th July, 1977]

Her Majesty, by and with the advice and

consent of the Senate and House of Commons

of Canada, enacts as follows:

PART I

SHORT TITLE

Short title

1. This Part may be cited as the Auditor General Act.

INTERPRETATION

Definitions

2. In this Act,

"Auditor General"

"Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"Crown corporation"

"Crown corporation" has the meaning assigned to that expression by subsection 66(1) of the Financial Administration Act;

"department"

"department" has the meaning assigned to that term by section 2 of the Financial Administration Act,'

"registrar"

"registrar" means the Bank of Canada and a registrar appointed under Part IV of the Financial Administration Act.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem

(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment

(3) Once having served as the Auditor General a person is not eligible for re-appointment to that office.

Vacancy

(4) In the event of the absence or incapacity of the Auditor General or if the Office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General.

Salary

4. (1) The Auditor General shall be paid a Salary equal to the salary of the Chief Justice of the Federal Court of Canada, including any additional salary authorized by section 20 of the Judges Act.

Pension benefits

(2) The provisions of the Public Service Superannuation Act, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than

sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the Diplomatic Service (Special) Superannuation Act in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the Public Service Superannuation Act do not apply to him.

DUTIES

Examination

5. The Auditor General is the auditor of Examination the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 55 of the Financial Administration Act to be included in the Public Accounts, and any other statement that the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

Report to House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue-and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of Commons December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 20(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require; and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*;

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

ACCESS TO INFORMATION

Access to Information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown Corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or an>' of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in *Appropriation Acts*, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 of that Act and inquiries under section 32 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 5(1)(e) and section 7 of that Act.

Collective agreements

17. Any collective agreement affecting persons employed in the office of the Auditor General entered into before the coming into force of this Act remains in force and binds the Auditor General as employer of such persons until the expiry of that agreement.

Classification standards

18. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

19. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 55 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

ESTIMATES

Estimates

20. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Appropriation allotments

21. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of office of the Auditor General

22. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

CONSEQUENTIAL AND RELATED AMENDMENTS

R.S., c. F-10

23. Part VII of the *Financial Administration Act* is repealed.

R.S., c. P.35

24. (1) Part I of Schedule I to the *Public Service Staff Relations Act* is amended by deleting there from the words "Office of the Auditor General of Canada".

(2) Part II of Schedule I to the *Public Service Staff Relations Act* is amended by adding thereto the words "Office of the Auditor General of Canada".

R.S., c. E-8

25. Section 16 of the *Established Programs (Interim Arrangements) Act* is repealed and the following substituted therefor:

Powers of Auditor General

"16. Nothing in this Act shall be construed to restrict the powers of the Auditor General of Canada under the *Auditor General Act*."

1970-71-72, c.52

26. Section 27 of the French version of the *Pilotage Act* is repealed and the following substituted therefor:

Vérificateur général

"27. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de chaque Administration et en fait rapport au Ministre."

R.S., c. N-22

27. Subsection 23(5) of the *Northwest Territories Act* is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territories, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

R.S., c. Y-2

28. Subsection 26(5) of the Yukon Act is repealed and the following substituted therefor:

Powers of Auditor General

"(5) The Auditor General has, in connection with his examination of the accounts of the Territory, all the powers that he has under the *Auditor General Act* in connection with the examination of the accounts of Canada."

1970-71-72, c. 48

29. Section 15 of the French version of the *Unemployment Insurance Act*, 1971 is repealed and the following substituted therefor:

Vérification

"15. Le vérificateur général vérifie chaque année la comptabilité et les opérations financières de la Commission et en fait rapport au Ministre."

Amendments to French version

30. Whenever, in the French version, the expression "auditeur général" appears in any provision of an Act listed in the schedule to this Act, there shall in every case, unless the context otherwise requires, be substituted the expression "vérificateur général".

PART III

COMMENCEMENT

Coming into force

31. This Act shall come into force on a day to be fixed by proclamation.

(The Act came into force August 1, 1977)

1978 Report of the Auditor General of Canada – Appendix B

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX B</H1>

</CENTER>

<HR>

FINANCIAL ADMINISTRATION ACT

R.S., F-10

Extracts from Part VIII

CROWN CORPORATIONS

Access to books, etc.

76. The auditor is entitled to have access at all convenient times to all records, documents, books, accounts and vouchers of a corporation, and is entitled to require from the directors and officers of the corporation such information and explanations as he deems necessary. R.S., c. 116, s. 86.

Auditor's report

77. (1) The auditor shall report annually to the appropriate Minister the result of his examination of the accounts and financial statements of a corporation, and the report shall state whether in his opinion

(a) proper books of account have been kept by the corporation;

(b) the financial statements of the corporation

(i) were prepared on a basis consistent with that of the preceding year and are in agreement with the books of account,

(ii) in the case of the balance sheet, give a true and fair view of the state of the corporation's affairs as at the end of the financial year, and

(iii) in the case of the statement of income and expense, give a true and fair view of the income and expense of the corporation for the financial year; and

(c) the transactions of the corporation that have come under his notice have been within the powers of the corporation under this Act and any other Act applicable to the corporation;

and the auditor shall call attention to any other matter falling within the scope of his examination that in his opinion should be brought to the attention of Parliament.

Other reports

(2) The auditor shall from time to time make to the corporation or to the appropriate Minister such other reports as he may deem necessary or as the appropriate Minister may require

Annual report

(3) The annual report of the auditor shall be included in the annual report of the corporation.

Audit

(4) Notwithstanding section 68, this section operates in lieu of section 132 of the Canada Corporations Act. R.S., c. 116, s.87.

Report through Minister

78. In any case where the auditor is of the opinion that any matter in respect of a corporation should be brought to the attention of the Governor in Council, the Treasury Board or the Minister of Finance, such report shall be made forthwith through the appropriate Minister. R.S., c. 116, s. 88.

1978 Report of the Auditor General of Canada – Appendix C

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX C</H1>

</CENTER>

<HR>

OPINION AND OBSERVATIONS BY THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA (Sections 2 and 3 of the Public Accounts, 1977-78)

SECTION 2

1977-78

PUBLIC ACCOUNTS

Audited

Financial Statements of the Government of Canada

CONTENTS

Opinion of the Auditor General on the Financial Statements of the Government of Canada

Statement of Revenue and Expenditure

Statement of Assets and Liabilities

Summary of Budgetary Appropriations, Expenditures and Unexpended Balances by Department

Notes to the Financial Statements of the Government of Canada

OPINION OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

This year, for the first time, I am reporting on the financial statements of the Government of Canada under the provisions of the Auditor General Act, S.C. 1976-77, c. 34, proclaimed on August 1, 1977. Section 6 of the Act requires me to express an opinion as to whether these financial statements present fairly information in accordance with the stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations I may have.

Accordingly, I have examined the financial statements of the Government of Canada for the year ended March 31, 1978, comprising:

the Statement of Revenue and Expenditure,

the Statement of Assets and Liabilities, and

the Summary of Budgetary Appropriations, Expenditures and Unexpended Balances by Department.

My examination was made in accordance with generally accepted auditing standards and included such inquiries, tests and other procedures as I considered necessary to enable me to report as required by Section 6 of the Auditor General Act.

In my opinion, these financial statements present information in accordance with the stated accounting policies of the Government of Canada as set out in Note 1 to the financial statements and on a basis consistent with that of the preceding year except for the change in the basis of translating to Canadian dollars the assets and liabilities denominated in foreign currencies which is set out in Note 3 (i) to the financial statements and with which I concur.

I have the following reservations concerning certain of the stated accounting policies of the Government of Canada which, in my opinion, affect the fairness of the information presented in the financial statements. I have commented on the matters described in these reservations in previous Reports to the House of Commons.

- As a result of the inclusion of certain balances identified in Notes 5 and 7 to the financial statements and designated for deletion from the accounts, assets and liabilities are overstated by \$3,481 million and \$52 million respectively. There is an allowance for losses on the realization of assets of \$546 million; however, this is a general allowance against all classes of assets.
- All Crown corporations named in Schedules C and D to the Financial Administration Act are excluded from the accounting entity of the Government of Canada. In my view, certain of these corporations should not be excluded from

the entity because they engage in government-type activities and are financially dependent on the public purse. If such corporations were included, the reported value of loans to and investments in them would be reduced to the extent it represents amounts, such as capital expenditures, that would have been charged to budgetary expenditure under the Government's stated accounting policies. (These loans and investments include certain amounts which are described below as being questionable on other grounds.)

- Certain Crown corporations have a history of deficits and lack sufficient revenues to repay their indebtedness to Canada. Loans to and investments in these corporations, totalling \$1,325 million, are questionable on these grounds. The reported value of loans to developing countries and loans to and subscriptions in international development associations, amounting to \$2,490 million, is questionable since by their terms these loans and subscriptions have the characteristics of grants or contributions. Under the Government's stated accounting policies grants and contributions are recorded as budgetary expenditures rather than assets.

Additional information and comments respecting these reservations are included in my observations on the financial statements in Section 3 of this volume.

J.J. Macdonell

Auditor General of Canada

Ottawa, Canada

September 15, 1978

GOVERNMENT OF CANADA

Statement of Revenue and Expenditure for the Year Ended March 31, 1978

(in millions of dollars)

	<u>Gross revenue</u>	Revenue credited to appropriations and postal receipts used to defray postal expenditure	<u>Net revenue</u>	
			<u>1978</u>	<u>1977</u>
REVENUE				
Tax revenue -				
Income tax -				
Personal	13,440		13,440	14,620
Corporation	5,828		5,828	5,377
Non-resident	503		503	451
Excise taxes and duties -				
Sales	4,427		4,427	3,929
Customs import duties	2,312		2,312	2,097
Excise duties	882		882	865
Special excise tax - Gasoline	598		598	600
Oil export charge	432		432	661
Other taxes	472		472	485
Other tax revenue	<u>66</u>		<u>66</u>	<u>70</u>
Total tax revenue	28,960		28,960	29,155
Non-tax revenue -				
Return on investments -				

Bank of Canada	786		786	703
Central Mortgage and Housing Corporation	700		700	606
Interest on bank deposits	196		196	202
Farm Credit Corporation	161		161	133
Exchange Fund Account	138		138	183
Other return on investments	604		604	670
	<u>2,585</u>		<u>2,585</u>	<u>2,497</u>
Postal revenue	773		773	615
Premium, discount and exchange	170		170	
Services and service fees	110		110	106
Privileges, licences and permits	63		63	63
Refunds of previous years' expenditures	52		52	184
Bullion and coinage	34		34	17
Proceeds from sales	25		25	18
Other non-tax revenue	<u>74</u>		<u>74</u>	<u>66</u>
Total non-tax revenue	3,886		3,886	3,566
Revenue credited to appropriations	888	888		
Postal receipts used to defray postal expenditures	<u>119</u>	<u>119</u>		
Total revenue	33,853	1,007	32,846	32,721
EXPENDITURE				
Agriculture	959		959	639
Communications	93	4	89	70
Consumer and Corporate Affairs	72		72	62
Energy, Mines and Resources	1,675	109	1,566	1,349

Environment	570	23	547	488
External Affairs	1,126		1,126	731
Finance	9,302	3	9,299	8,326
Governor General and Lieutenant-Governors	3		3	3
Indian Affairs and Northern Development	1,170		1,170	1,016
Industry, Trade and Commerce	543		543	773
Justice	101		101	85
Labour	50	9	41	32
Manpower and Immigration	2,638		2,638	2,773
National Defence	3,976	205	3,771	3,371
National Health and Welfare	11,187	14	11,173	10,953
National Revenue	555	33	522	454
Parliament	89		89	73
Post Office	1,400	163	1,237	1,115
Privy Council	44		44	33
Public Works	872	64	808	689
Regional Economic Expansion	562		562	495
Science and Technology	281	7	274	242
Secretary of State	2,206	13	2,193	1,573
Solicitor General	953	146	807	687
Supply and Services	176	49	127	117
Transport	1,624	153	1,471	1,318
Treasury Board	185	5	180	134
Urban Affairs	636	7	629	625
Veterans Affairs	<u>841</u>		<u>841</u>	<u>785</u>

Total expenditure	43,889	1,007	42,882	39,011
Total revenue			<u>32,846</u>	<u>32,721</u>
BUDGETARY DEFICIT			10,036	6,290

The accompanying notes are an integral part of this statement.

Details of revenue and expenditure by department can be found in Sections 4 and 5 and in the departmental sections of Volume II.

September 15, 1978.

T. K. SHOYAMA.

Deputy Minister of Finance.

J. L. FRY,

Deputy Receiver General for Canada.

GOVERNMENT OF CANADA

Statement of Assets and Liabilities as at March 31, 1978

(in millions of dollars)

	<u>1978</u>	<u>1977</u>	<u>Net increase or decrease (-)</u>
ASSETS			
Loans, investments and advances -			
Crown corporations and agencies, Schedule A, Section 8 -			
Lending institutions -			
Central Mortgage and Housing Corporation	9,705	9,173	532
Export Development Corporation	1,474	1,390	84
Farm Credit Corporation	2,535	2,238	297
Federal Business Development Bank	745	504	241
Municipal Development and Loan Board - Advances	192	202	-10
Other	6	16	-10
	14,657	13,523	1,134
All other Crown corporations -			
Air Canada	310	313	-3
Atomic Energy of Canada Limited	1,120	1,204	-84
Canadian National Railways	3,022	2,923	99
Petro-Canada	644	494	150
Other	1,767	1,983	-216
	6,863	6,917	-54
Total Crown corporations and agencies	21,520	20,440	1,080

Other loans, investments and advances -			
Provincial and territorial governments, Schedule B, Section 8	1,466	1,343	123
National governments including developing countries, Schedule C, Section 8	2,224	2,272	-48
Veterans' Land Act Fund advances less allowance for conditional benefits, Schedule D, Section 8	439	476	-37
Government controlled corporations, Schedule E, Section 8	447	446	1
Private sector enterprises, Schedule F, Section 8	128	137	-9
Inactive loans, Schedule G, Section 8	56	56	
Miscellaneous, Schedule H, Section 8	175	184	-9
	4,935	4,914	21
<i>TOTAL LOANS, INVESTMENTS AND ADVANCES</i>	26,455	25,354	1,101
Other assets, Schedule I, Section 8 -			
Cash in transit	1,026	838	188
Unemployment Insurance - Non-interest-bearing advances	2,114	1,734	380
Provincial tax collection agreements account		71	-71
Working capital advances to revolving funds, departments and agencies	843	727	116
Unamortized bond flotation costs	140	140	
<i>TOTAL OTHER ASSETS</i>	4,123	3,510	613
Foreign assets -			
Exchange Fund Account	2,969	3,217	-248
Subscriptions, loans and advances - International Monetary Fund	1,542	1,232	310
Other international organizations, Schedule J, Section	1,377	1,125	252

8			
<i>TOTAL FOREIGN ASSETS</i>	5,888	5,574	314
Cash balances, Schedule K, Section 8	<u>4,506</u>	<u>3,597</u>	<u>909</u>
TOTAL ASSETS	40,972	38,035	2,937
Less: allowance for losses on realization of assets, Schedule L, Section 8	546	546	
Fixed assets (valued at one dollar)			
NET RECORDED ASSETS	40,426	37,489	2,937
Excess of recorded liabilities over net recorded assets, Schedule M, Section 8	<u>39,622</u>	<u>29,586</u>	<u>10,036</u>
TOTAL	80,048	67,075	12,973
LIABILITIES			
Annuity, insurance and pension accounts, Schedule N, Section 8 -			
Canada Pension Plan account	13,019	11,357	1,662
Less: provincial government securities in investment fund	12,420	10,851	1,569
	599	506	93
Superannuation accounts	17,266	15,730	1,536
Less: unamortized portion of actuarial deficiencies	1,510	1,723	-213
	15,756	14,007	1,749
Government annuities	1,232	1,241	-9
Other	580	407	173
	1,812	1,648	164
<i>TOTAL ANNUITY, INSURANCE AND PENSION ACCOUNTS</i>	18,167	16,161	2,006
Other liabilities -			

Interest and matured debt, Schedule O, Section 8	4,714	3,743	971
<i>Less: discount on Treasury bills</i>	191	124	67
	4,523	3,619	904
Accounts payable and accrued salaries, Schedule O, Section 8	1,187	1,708	-521
Outstanding cheques, warrants and money orders, Schedule O, Section 8	2,021	1,389	632
Provincial tax collection agreements account, Schedule P, Section 8	259		259
Undisbursed balances of appropriations to special accounts, Schedule Q, Section 8	52	38	14
Deposit and trust accounts, Schedule P, Section 8	588	414	174
Other, Schedule O, Section 8	123	111	12
<i>TOTAL OTHER LIABILITIES</i>	<i>8,753</i>	<i>7,279</i>	<i>1,474</i>
Foreign liabilities -			
Notes payable to - International Monetary Fund	885	625	260
Other international organizations, Schedule R, Section 8	355	282	73
Special Drawing Rights	503	370	133
Unmatured debt payable in foreign currency	1,019	164	855
<i>TOTAL FOREIGN LIABILITIES</i>	<i>2,762</i>	<i>1,441</i>	<i>1,321</i>
Unmatured debt, Schedule S, Section 8 -			
Marketable bonds	21,327	17,888	3,439
Canada savings bonds	18,011	16,304	1,707
Special non-marketable bonds	84	72	12
Treasury bills	11,295	8,255	3,040
Notes payable to Canadian banks	850		850

Total unmatured debt outstanding	51,567	42,519	9,048
<i>Less: Government's holdings of unmatured debt -</i>			
Marketable bonds	13	11	2
Canada savings bonds held on account of employees	85	78	7
Special non-marketable bonds issued to Canada Pension Plan investment fund	84	72	12
Total unmatured debt held by outside parties	51,385	42,358	9,027
<i>Less: unmatured debt payable in foreign currency</i>	1,019	164	855
<i>TOTAL UNMATURED DEBT PAYABLE IN CANADIAN CURRENCY</i>	<u>50,366</u>	<u>42,194</u>	<u>8,172</u>
TOTAL	80,048	67,075	12,973

The accompanying notes are an integral part of this statement.

Details of the assets and liabilities can be found in Sections 6, 7 and 8.

September 15, 1978.

T. K. SHOYAMA,

Deputy Minister of Finance.

J. L. FRY,

Deputy Receiver General for Canada.

GOVERNMENT OF CANADA

Summary of Budgetary Appropriations, Expenditures and Unexpended Balances by Department for the Year Ended March 31, 1978

(in millions of dollars)

<u>Department</u>	<u>Appropriations</u>	<u>Expenditures</u>	<u>Variances</u>		
			<u>Unexpended Balances</u>		<u>Over-expended</u>
			<u>Lapsed</u>	<u>Carried forward</u>	
Agriculture	1,016(2)	959	34	23(1)	
Communications	100	89	11		
Consumer and Corporate Affairs	75	72	3		
Energy, Mines and Resources	1,577	1,566	11		
Environment	567	547	20		
External Affairs	1,226	1,126	100		
Finance	9,301	9,299	2		
Governor General and Lieutenant-Governors	3	3			
Indian Affairs and Northern Development	1,193(3)	1,170	23	(1)	
Industry, Trade and Commerce	560	543	17		
Justice	106	101	5		
Labour	42	41	1		
Manpower and Immigration	2,695	2,638	57		
National Defence	3,796	3,771	25		

National Health and Welfare	11,246	11,173	73		
National Revenue	528	522	6		
Parliament	90	89	1		
Post Office	1,254	1,237	17		
Privy Council	45	44	1		
Public Works	833	808	25		
Regional Economic Expansion	593	562	31		
Science and Technology	278	274	4		
Secretary of State	2,207(4)	2,193	14		(5)
Solicitor General	849	807	42		
Supply and Services	132	127	5		
Transport	1,548	1,471	77		
Treasury Board	380	180	200		
Urban Affairs	749	629	120		
Veterans Affairs	893	841	52		
Total	43,882	42,882	977	23	

(1) Available for expenditure in subsequent years: Department of Agriculture Vote 15, 1971-72 and 1972-73, \$23,021,003; Department of Indian Affairs and Northern Development Vote 30, 1971-72, \$336,764.

(2) Includes \$24,775,776 carried forward from Vote 15, Department of Agriculture 1971-72, 1972-73 appropriations.

(3) Includes \$336,764 carried forward from Vote 30, Department of Indian Affairs and Northern Development 1971-72 appropriations.

(4) Includes \$55,588 carried forward from Vote 2b, Department of Secretary of State 1968-69 appropriations. The carry over provision of this vote was cancelled in 1977-78.

(5) Represents an over-expenditure of \$137,402 in Vote 65, Department of Secretary of State.

The accompanying notes are an integral part of this statement.

Details of appropriations and/or expenditures by department can be found in Section 5 and in the departmental sections of Volume II.

September 15, 1978.

T.K. SHOYAMA,

Deputy Minister of Finance.

J.L. FRY,

Deputy Receiver General for Canada.

Notes to the Financial Statements of the Government of Canada

1. Significant accounting policies and practices

The accounting policies and practices of the Government of Canada have evolved over many years. They are based on concepts embodied in the British North America Act, the Financial Administration Act and other legislation.

i. *Basic concepts*

The two basic concepts on which the Government's accounting system is based are found in the British North America Act: first, the concept of the Consolidated Revenue Fund, which emanates from the requirement that all duties and revenues received, other than those reserved to the provinces, "shall form One Consolidated Revenue Fund"; second, the concept that the balance of the Fund, after certain prior charges, "shall be appropriated by the Parliament of Canada".

Parliament provides authority to make payments out of the Consolidated Revenue Fund in annual appropriation acts and other statutes (referred to as statutory appropriations). The spending authority granted in appropriation acts is for stated purposes and maximum amounts. Unless provided for in the wording of the votes, unused balances of the spending authority granted in appropriation acts lapse at the end of the year for which it was granted. The spending authority provided by statutory appropriations is for specified purposes and for such amounts and such time as the acts prescribe. The spending authority provided by statutory appropriations does not lapse at the end of the year in which it was granted.

ii. *Government of Canada as an accounting entity*

As an accounting entity, the Government of Canada is defined as all the departments named in Schedule A of the Financial Administration Act; any division or branch of the Public Service of Canada, including a commission appointed under the Inquiries Act designated by the Governor in Council as a department for purposes of the Financial Administration Act; the staffs of the Senate, the House of Commons, and the Library of Parliament; and, any corporation named in Schedule B of the Financial Administration Act.

In accordance with the above definition, the financial statements of the Government have not been prepared on a consolidated basis and therefore do not reflect the operations of the corporations named in Schedules C and D of the Financial Administration Act. In addition, the Exchange Fund Account, the Canada Pension Plan Account, the Unemployment Insurance Account, the revolving funds and certain similar accounts have separate financial statements which are not combined with those of the Government.

iii. *Classification of financial transactions*

The financial transactions of the Government of Canada as recorded in the accounts of Canada and reflected in the Public Accounts are classified into budgetary transactions and other transactions consisting of non-budgetary, foreign exchange and unmatured debt transactions.

In general terms, budgetary transactions are those which enter into the calculation of the annual budgetary surplus or deficit and are disclosed on the Government's Statement of Revenue and Expenditure. The other transactions lead to the acquisition or disposal of financial claims or to the creation or discharge of financial obligations which are disclosed on the Statement of Assets and Liabilities.

For purposes of accounting and reporting, the Public Accounts uses the classification in force at the end of the year to which the report refers and presents comparative figures for the previous year on a consistent basis.

iv. *Budgetary revenue*

Revenue consists of all tax and non-tax receipts which affect the budgetary deficit or surplus of the Government and includes revenue internal to the Government.

The Government of Canada generally reports revenue in the year in which it is received with refunds of revenue allocated to the year in which they are actually paid.

Revenue is stated after deducting refunds paid and excludes amounts receivable, taxes collected on behalf of provinces, receipts from contributors to the Canada Pension Plan, the Unemployment Insurance and the superannuation accounts, and receipts and revenues credited to revolving funds and to other asset and liability accounts.

Revenue is stated both gross and net. The difference between the two is revenue credited to appropriations and postal receipts used to defray postal expenditures.

v. *Budgetary expenditure*

Expenditure consists of all charges to budgetary appropriations for goods and services and for transfer payments which affect the budgetary deficit or surplus of the Government. Expenditure includes:

- Payments made during the year for goods and services, and for transfer payments;
- Payments made according to the provisions of the Financial Administration Act within thirty days following the end of the year, on account of debts incurred prior to the end of the year for work performed, goods received, services rendered, or resulting from contractual arrangements;
- Interest accrued on the public debt;
- Accruals of certain salaries and wages earned but not paid at the end of the year;
- Interest and Government contributions credited to superannuation, other annuity, insurance and pension accounts and to the Unemployment Insurance Account;
- Write-off of assets;
- Amortization of discount on Treasury bills and actuarial deficiencies of superannuation accounts;

- Amounts credited to the undisbursed balances of appropriations to special accounts;
- Expenditures internal to the Government.

Expenditure is stated both gross and net. The difference between the two is revenue credited to appropriations and postal receipts used to defray postal expenditures. Expenditure does not include pensions paid under the Canada Pension Plan, superannuation and other pension accounts, Unemployment Insurance payments other than benefits to fishermen, payments financed from undisbursed balances of appropriations to special accounts and payments charged to working capital advance accounts and to revolving funds and other asset and liability accounts.

vi. *Assets and liabilities*

Assets are defined as the financial claims acquired by the Government of Canada on outside organizations and individuals as a result of events and transactions prior to the accounting date. Liabilities are defined as financial obligations to outside organizations and individuals as a result of events and transactions prior to the accounting date.

However, as a result of the Government's accounting policies and practices described above, and in accordance with the provisions of the Financial Administration Act, certain financial claims and obligations are not reported on the Statement of Assets and Liabilities.

The most important types of financial claims not so reported are the accounts receivable both for tax and non-tax revenue. Similarly, the financial obligations not so reported include: accounts payable for goods and services received in the year but not paid within thirty days from the end of the year; accounts payable related to statutory appropriations; accrued liabilities for certain retroactive salary and wage settlements, for unpaid overtime, annual vacation and unused sick leave, and for benefits payable upon termination of employment; actuarial liabilities arising from the indexing to the cost of living of superannuate pensions and annuities.

The Statement of Assets and Liabilities includes, however, certain balances of accounts internal to the Government (Note 7) which will continue to be reported until parliamentary authority to delete them from the accounts of Canada has been obtained.

vii. *Valuation of assets and liabilities*

Assets are recorded at cost except for:

- Assets denominated in foreign currencies, which are translated to Canadian currency at year-end closing rates of exchange; and
- Fixed assets, which are carried at the nominal value of \$1.

Assets have not been subject to revaluation to reflect collectable or recoverable values. However, a general allowance for losses on all classes of assets has been provided. This allowance does not constitute a reserve related to any specific asset or classes of assets.

Liabilities denominated in foreign currencies are translated to Canadian currency at year-end closing rates of exchange. All other liabilities are recorded in the amounts ultimately payable except for the superannuation accounts of the Canadian Forces, the Public Service and the Royal Canadian Mounted Police and the Government annuities account, which are valued on an actuarial basis; the Canada Pension Plan Account and the Supplementary Retirement Benefits Account are not maintained on an actuarial basis. However, the Canada Pension Plan Act limits payments from the Consolidated Revenue Fund to the amount of the outstanding balance in the Canada Pension Plan Account.

2. Changes in financial statement presentation

Changes have been made in the financial statements, in accordance with recommendations made in the Report on the Study of the Accounts of Canada.

i. Statement of Revenue and Expenditure

Gross postal receipts amounting to \$119 million used to defray certain postal expenditures under the authority of the Post Office Act are included in gross revenue and expenditure. The comparative figure for 1976-77 was \$103 million.

ii. Statement of Assets and Liabilities

The order in which assets and liabilities are displayed in the Statement of Assets and Liabilities has been slightly modified to make it consistent with Section 1 of this volume.

3. Changes in accounting practices

i. Translation of assets and liabilities denominated in foreign currencies

A change has been made in the practice of reporting assets and liabilities denominated in foreign currencies which are now translated at the year-end closing rates of exchange. Previously, such assets and liabilities, other than cash and short-term liabilities, were reported at historical values. Cash and short-term liabilities have always been translated at year-end closing rates of exchange.

This change has been made to introduce consistency in the translation of assets and liabilities denominated in foreign currencies and to reflect more accurately the current value of the financial claims and obligations of the Government.

This change has been reflected in the accounts as follows:

- Revenue has been increased by \$170 million, including \$162 million attributable to previous years, and \$8 million attributable to 1977-78;
- Assets have been increased by \$320 million, including \$225 million applicable to assets of March 31, 1977, and \$95 million to those of 1977-78; and
- Liabilities have been increased by \$150 million, including \$63 million applicable to liabilities of March 31, 1977, and \$87 million to those of 1977-78.

ii. *Accounting for revenue from the private sector credited to appropriations*

Effective in 1977-78, the authority to spend revenue received from the private sector was discontinued for certain programs. In accounting for this change, such revenues are now credited to revenue rather than to appropriations. For comparative purposes, various non-tax revenue accounts have been increased by \$81 million for 1976-77. Offsetting increases to net departmental expenditures have been made as follows:

	<u>(in millions of dollars)</u>
Agriculture -	
Production and marketing	1
Health of animals	5
Communications	18
Customs and Excise	2
Energy, Mines and Resources -	
Earth sciences	3
Indian Affairs and Northern Development -	
Parks Canada	11
Insurance	3
Public Works -	
Land management and development	4
Veterans Affairs -	
Treatment services	<u>34</u>
	81

iii. *Undisbursed balances of appropriations to special accounts*

The following account was eliminated from this category:

The National Defence - Surplus Crown assets account was revoked by authority of Appropriation Act No 4, 1977-78. The opening balance of \$11 million and \$1 million received during the year were credited to expenditure.

4. Amounts credited or charged to asset and liability accounts

According to the Government's stated accounting policies and practices, certain receipts and payments have been credited or charged to asset and liability accounts. The two more important groups are described below:

i. *Annuity, insurance and pension accounts*

The Unemployment Insurance Account, the Canada Pension Plan Account and the Government superannuation accounts are maintained separately within the accounts of Canada and accordingly receipts and payments made for these accounts are not reflected in revenue and expenditure:

	<u>(in millions of dollars)</u>			
	<u>1978</u>		<u>1977</u>	
	<u>Credits</u>	<u>Charges</u>	<u>Credits</u>	<u>Charges</u>
Canada Pension Plan Account	2,767	1,105	2,461	874
Unemployment Insurance Account	3,982	4,362	4,261	3,670
Superannuation accounts	2,039	503	1,949	476
Government annuities	87	96	92	93
Other annuity, insurance and pension accounts	361	188	143	43

ii. *Departmental asset and liability accounts*

Receipts and payments for the following accounts are not reflected in revenue and expenditure:

	<u>(in millions of dollars)</u>			
	<u>1978</u>		<u>1977</u>	
	<u>Credits</u>	<u>Charges</u>	<u>Credits</u>	<u>Charges</u>
Airports Revolving Fund	42	68	41	70
Transport-Railway grade crossing Fund		16		27
Urban Affairs-National capital Fund		17		21
Deposit and trust accounts	9	2	14	3

5. Loans likely to require parliamentary appropriations for write-off

The loans described below are likely to require Parliamentary appropriations for write-off in subsequent years; until such appropriations are obtained, the assets are overstated by the following amounts:

	<u>(in millions of dollars)</u>	
	<u>1978</u>	<u>1977</u>
Canadian Broadcasting Corporation	198	198
National Capital Commission	38	38
Northwest Territories	105	105
Yukon Territory	<u>43</u>	<u>43</u>
	384	384

6. Revolving funds

Revolving funds are authorizations by Parliament to draw monies from the Consolidated Revenue Fund for prescribed purposes, up to a given maximum at any one time, which, together with attendant receipts, may be expended for those purposes on a continuing basis.

The year-end balances of the amounts advanced from the Consolidated Revenue Fund are included as assets in the Statement of Assets and Liabilities. Surpluses or deficits of revolving funds are included in revenue or expenditure in accordance with Treasury Board policy unless special permission is granted to carry over surpluses and accumulated deficits.

In 1977-78, cumulative surpluses totalling \$8 million (\$6 million in 1976-77) have been transferred to non-tax revenue while cumulative deficits of \$3 million (\$3 million in 1976-77) have been recouped from appropriations.

However, cumulative surpluses of \$35 million (\$55 million in 1976-77) have not been transferred to non-tax revenue and cumulative deficits of \$1 million (\$1 million in 1976-77) have not been recouped from appropriations. Of these cumulative surpluses, the Airport Revolving Fund and the Supply Revolving Fund accounted for \$22 million (\$46 million in 1976-77) and \$11 million (\$8 million in 1976-77) respectively.

7. Accounts internal to the Government

Certain accounts reported as assets and liabilities do not meet the definitions stated in Note 1 (vi). However, these accounts will continue to be reported on the Statement of Assets and Liabilities until such time as parliamentary authority is obtained to delete them.

Accounts internal to the Government reported as assets, represent deferred expenditures chargeable to subsequent years, in accordance with legislation, regulations or established practice. Those reported as liabilities represent spending authority carried forward to future years.

The balances of these accounts in the Statement of Assets and Liabilities as at March 31 have the effect of overstating the assets and liabilities by the following amounts:

	<u>(in millions of dollars)</u>	
	<u>1978</u>	<u>1977</u>
ASSETS		
Unemployment Insurance advances	2,114	1,734
Working capital advances to revolving funds, departments and agencies	843	727
Unamortized bond flotation costs	<u>140</u>	<u>140</u>
	<u>3,097</u>	<u>2,601</u>
LIABILITIES		
Undisbursed balances of appropriations to special accounts	52	38

8. Annuity, insurance and pension accounts

i. *Canada Pension Plan Account*

The Canada Pension Plan Account is not maintained on an actuarial basis because the Canada Pension Plan Act limits payments from the Consolidated Revenue Fund to the amount of the outstanding balance in the account. Financial statements of the Canada Pension Plan Account can be found in Section 15 of Volume II.

ii. *Unamortized portions of actuarial deficiencies of superannuation accounts*

These accounts record the unamortized portions of the actuarial deficiencies in the Public Service Superannuation Account, the Canadian Forces Superannuation Account, and the Royal Canadian Mounted Police Superannuation Account which have been set up as deferred charges and credited to the superannuation accounts.

Adjustments for actuarial deficiencies in respect, of authorized salary increases and quinquennial valuation were recorded in 1977-78 in the amount of \$616 million while amortization to expenditure was \$829 million. In 1976-77, adjustments were \$677 million and amortization was \$784 million. An actuarial deficiency of \$15 million was determined during the

year based on the quinquennial valuation of the Royal Canadian Mounted Police Superannuation Account as at December 31, 1974.

Actuarial valuations are made quinquennially, the next of which will be made effective December 31, 1977 for the Public Service Superannuation Account, December 31, 1975 for the Canadian Forces Superannuation Account and December 31, 1979 for the Royal Canadian Mounted Police Superannuation Account.

Any actuarial deficiency revealed will be credited to the account and charged to unamortized portions of actuarial deficiencies and amortized to expenditure in five equal annual instalments commencing in the year in which the report is laid before Parliament. The cost of added liabilities under the superannuation acts as a result of the authorization of salary increases is to be credited to the superannuation accounts and charged to unamortized portions of actuarial deficiencies and amortized to expenditure over a period of five years commencing in the year in which the increases are authorized.

iii. *The Supplementary Retirement Benefits Account*

The Supplementary Retirement Benefits Account was established in 1970 for the payment of increased pension benefits resulting from indexation. No actuarial valuations are required to be made of the account.

Increased superannuation benefits paid during the year due to indexation amounted to \$170 million (\$131 million in 1976-77). In accordance with legislation, \$165 million (\$126 million in 1976-77) representing benefits to superannuates in excess of their share of contributions to the account was charged to expenditures. Only \$5 million (\$5 million in 1976-77) was charged to the Supplementary Retirement Benefits Account.

9. **Unrecorded accounts payable**

According to the Government's accounting policies and practices, only the payments made within thirty days following the end of the year relating to debts incurred prior to the end of the year for work performed, goods received, services rendered or resulting from contractual arrangements are recorded as accounts payable. Of the unrecorded accounts payable, the following are summarized:

	<u>(in millions of dollars)</u>	
	<u>1978</u>	<u>1977</u>
Accounts payable for goods and services	77	46
Retroactive salary and wage payments	<u>39</u>	<u>44</u>
	116	90

Details of unrecorded accounts payable can be found in Section 9 of Volume I of the Public Accounts, "Summary of Accounts Properly Chargeable to 1977-1978 but carried over to 1978-79."

Retroactive salary and wage payments represent pay adjustments partly applicable to 1977-78 which have been or will be paid in 1978-79 resulting from collective bargaining agreements.

10. Foreign assets and liabilities

The foreign assets and liabilities recorded under these headings are those which can be identified with Canada's foreign exchange operations and investments in international banking institutions. Some are denominated in foreign currencies and some are denominated in Canadian currency. Assets and liabilities denominated in foreign currencies are recorded at the Canadian currency equivalent at March 31st. There are other foreign assets and liabilities such as foreign bank balances which are included with other cash balances at their Canadian dollar equivalents and amounts denominated in foreign currencies which are held in deposit and trust accounts.

11. Maturity of Government debt

The following amounts represent that portion of unmatured debt maturing in the next five years:

	<u>(in millions of dollars)</u>				
	<u>Treasury bills</u>	<u>Marketable bonds</u>	<u>Canada savings bonds</u>	<u>Notes payable to Canadian banks</u>	<u>Total</u>
1979	11,295	2,099	2,640	850	16,884
1980		3,047	143	3,190	
1981		2,932	919	3,851	
1982		1,594	804	2,398	
1983		<u>2,401</u>	<u>277</u>	<u>2,678</u>	
	11,295	12,073	4,783	850	29,001

It should be noted however that all Canada savings bonds are redeemable on demand regardless of maturity date.

Details of unmatured debt may be found in Section 8 of this volume.

12. Gross liabilities of the Government of Canada

The Statement of Assets and Liabilities has been prepared in accordance with the concept that assets are financial claims acquired by the Government of Canada on outside parties and liabilities are its financial obligations to outside parties. The deferred expenditure charges and accounts internal to the Government are not in keeping with this concept. To arrive at the gross liabilities of the Government, the amounts are adjusted as shown in the following table:

	<u>(in millions of dollars)</u>		
	<u>1978</u>	<u>1977</u>	Net increase or <u>decrease (-)</u>
Total liabilities per statement	80,048	67,075	12,973
Unamortized portions of actuarial deficiencies	1,510	1,723-	213
Discount on Treasury bills	191	124	67
Undisbursed balances of appropriations to special accounts (accounts internal to the Government)	<u>-52</u>	<u>-38</u>	<u>-14</u>
	81,697	68,884	12,813

13. Contingent liabilities of the Government of Canada

The contingent liabilities of the Government of Canada as at March 31, 1978, are as follows:

	<u>(in millions of dollars)</u>	
	<u>1978</u>	<u>1977</u>
Borrowings by Crown Corporations under guarantee or as agents of the Government	2,176	1,555
Insured loans under the National Housing Act, 1954	17,874	15,130
Other	<u>3,686</u>	<u>2,128</u>
	23,736	18,813

Details are listed in Section 8 of this volume.

14. Events subsequent to the end of the year

The following events have occurred subsequent to the end of the year:

i. *Revolving standby credit facilities*

In December 1977, the Government entered into an agreement with the Bank of Canada and the Canadian chartered banks to establish with the chartered banks a seven year revolving standby credit facility under which up to \$1,500 million US could be borrowed; this amount was increased to \$2,500 million US in April 1978.

As at March 31, 1978, drawdowns under this facility amounted to \$750 million US (\$850 million Canadian). These transactions were recorded in the accounts of Canada by increases in the advance to the Exchange Fund Account and the recording of liabilities for Notes payable to Canadian banks totalling \$850 million Canadian.

As of September 15, 1978, drawings amounted to \$3,250 million US and repayments were \$2,750 million US, leaving \$500 million US outstanding at September 15, 1978.

In June 1978, the Government entered into an eight year revolving standby credit facility agreement with a group of United States and other foreign banks under which up to \$3,000 million US could be borrowed during the first four years of the agreement; during the succeeding four years the amount available would be reduced in steps, to one-third of the original amount.

As of September 15, 1978, aggregate drawings under this facility were \$1,000 million US, all of which was outstanding at that date.

ii. *Capital reorganization of Air Canada*

The Air Canada Act, 1977, authorized the reorganization of Air Canada, including its capital structure. Although the act was assented to in February 1978, the Governor in Council Order necessary to effect the capital reorganization was not issued until April 13, 1978 and consequently, the effects of the reorganization on the Government's investment in Air Canada are not reflected in the 1978 Public Accounts.

The capital reorganization involved:

- The conversion of \$324 million of debt owed by Air Canada to the Government and to the Canadian National Railways into an equivalent amount of equity;
- The cancellation of \$5 million of Air Canada capital stock held by the Canadian National Railways in return for the cancellation of \$5 million of debt owed by the Canadian National Railways to the Government; and
- The issuance of \$5 million of Air Canada capital stock to the Government.

This resulted in the Government becoming the direct sole owner of Air Canada's 329,009 issued shares valued at \$329 million.

Residual debt totalling \$311 million owed by Air Canada to the Government and the Canadian National Railways, was consolidated into a single note repayable to the Government over 15 years, at a nominal rate of interest of 7.243%, in equal semi-annual instalments of principal and interest.

As a result of this recapitalization, the debt owed by the Canadian National Railways to the Government was reduced by some \$349 million, an amount equivalent to the Canadian National Railways' investment in Air Canada prior to the recapitalization.

iii. *Capital revision of Canadian National Railways*

Amendments to the Canadian National Railways Capital Revision Act and the Railway Act, authorized a revision of the capital structure of the Canadian National Railways. Although the amending act is retroactive to December 31, 1977, Royal Assent was not obtained until June 30, 1978, and the Governor in Council Orders necessary to effect the capital revision have not yet been issued. Consequently, the effects of the revision are not reflected in the 1978 Public Accounts.

The result of the revision is that the capital structure of the Canadian National Railways will be changed by the cancellation of \$808 million of loans and advances and a corresponding increase in the value of the no par value shares. The value of these shares will be further increased by: \$1,556 million, representing the value of the 4% preferred shares outstanding at December 31, 1977, which are to be cancelled; the \$428 million of capital investment in Canadian Government Railways; and an adjustment of \$808 million for depreciation not charged to operations in previous years. The authorized and issued capital stock of the National Company will remain at 6 million shares. The act also makes provision for the payment of dividends to the Receiver General.

The Government's 100% ownership of the Canadian National Railways is not affected by the capital revision.

SECTION 3

1977-78

PUBLIC ACCOUNTS

Observations by the Auditor

General on the

Financial Statements

of the Government

of Canada

CONTENTS

Introduction

Change in accounting policy

Assets and liabilities designated for deletion

The accounting entity

Loans, investments and advances, the reported value of which is questionable

Disclosure of additional information in the audited financial statements

Implementation of recommendations of the Study of the Accounts of Canada

Observations by the Auditor General

on the

Financial Statements of the Government of Canada

Introduction

I have examined the financial statements of the Government of Canada for the year ended March 31, 1978, which, together with my opinion, are included in Section 2 of this volume. These financial statements are the Statement of Revenue and Expenditure, the Statement of Assets and Liabilities, and the Summary of Budgetary Appropriations, Expenditures and Unexpended Balances by Department. My examination was made in accordance with generally accepted auditing standards and included such inquiries, tests and other procedures as I considered necessary to enable me to report as required by Section 6 of the Auditor General Act.

I am, for the first time, expressing an opinion in accordance with Section 6 of the new Auditor General Act, which provides that:

The Auditor General shall examine the several financial statements required by section 55 of the Financial Administration Act to be included in the Public Accounts, and any other statements that the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

My opinion includes a number of reservations with respect to certain accounting policies of the Government of Canada which, in my view, affect the fairness of the information presented in the financial statements. These reservations relate to balances designated to be deleted from the accounts but reported as assets and liabilities, the effect of excluding certain Crown corporations from the government accounting entity and the reported value of certain loans, investments and advances. I have reported on the matters described in these reservations in previous years.

The observations that follow provide additional information and comments on the reservations included in my opinion. They also provide comments concerning additional information which, in my view, should be included as a part of the financial statements of the Government submitted for audit and comments on the progress made by the Government in implementing the recommendations of the Study of the Accounts of Canada.

Change in Accounting Policy

As explained in Note 3 (i) to the financial statements, all assets and liabilities denominated in foreign currency are translated to Canadian dollars at year-end closing rates of exchange, with any gain or loss recorded as revenue or expenditure in the year. In prior years, only cash and short-term liabilities denominated in foreign currency were translated to Canadian dollars at year-end closing rates of exchange; all other assets and liabilities denominated in

foreign currency were translated at the exchange rates prevailing at the time such assets were acquired or liabilities incurred.

This change in accounting policy, with which I concur, provides for a more current measure, in Canadian dollars, of those financial claims and obligations of the Government denominated in foreign currency.

Assets and Liabilities Designated for Deletion

Certain amounts do not represent assets and liabilities of the Government of Canada because they are not recoverable from or payable to outside organizations or individuals. The amounts reported as assets are a deferral of current and prior years' expenditures and are treated in this manner either because of the requirements of the underlying legislation Or because write-off action has not been initiated. Those reported as liabilities represent spending authority carried forward to future years. These amounts identified as "Accounts internal to the Government" and "Loans likely to require parliamentary appropriation for write-off" overstate assets by \$3,481 million and liabilities by \$52 million.

Accounts internal to the Government

Note 7 to the financial statements identifies the following accounts reported as assets and liabilities which do not constitute financial claims on or obligations to organizations or individuals outside the Government.

<u>Assets</u>	
Working capital advances to revolving funds, departments and agencies	\$ 843 million
Unemployment Insurance advances	2,114 “
Unamortized bond flotation costs	140 “
	\$ 3,097 million
<u>Liabilities</u>	
Undisbursed balances of appropriations to special accounts	\$ 52 million

These balances have been designated by the Government for deletion when parliamentary approval is obtained.

The working capital advances to revolving funds, departments and agencies are not recoverable from parties outside the Government. These advances principally represent the acquisition of fixed assets and inventories which would otherwise be treated as budgetary expenditures under stated government accounting policies. This inconsistency in accounting for assets and expenditures was recognized by the Study of the Accounts of Canada in its

recommendation that such advances be treated as budgetary expenditures and not carried as assets.

Unemployment Insurance non-interest bearing advances primarily represent amounts for benefit payments to be borne by the Government which, because of provisions in the underlying legislation, have not been recorded as budgetary expenditures in the year in which the benefits were paid. Accordingly, these advances represent a deferral of expenditures and the Study of the Accounts of Canada recommended their deletion as assets. To implement this recommendation, underlying legislation will have to be amended to permit such advances to be recorded as budgetary expenditures in the same fiscal period in which the related benefits were paid.

Before 1977, bond flotation costs were recorded as assets and charged to expenditure over the life of the related debt issue. In 1977 and subsequent years, the Government has recorded bond flotation costs on new issues as budgetary expenditures. The balance of unamortized bond flotation costs on previous years' issues represents a deferral of expenditure and should also be written off.

Loans likely to require parliamentary appropriation for write-off

In Note 5 to the financial statements, the following loans are identified as likely to require parliamentary appropriation for write-off:

Canadian Broadcasting Corporation	\$ 198 million
National Capital Commission	38 “
Northwest Territories	105 “
Yukon Territory	<u>43 “</u>
	\$ 384 million

These loans were made before March 31, 1975, to finance capital expenditures of these entities. Since that date, such capital expenditures have been financed by budgetary appropriations of Canada. Payments of principal and interest on these loans have been deferred by the Government until 1979.

Allowance for losses on realization of assets

The allowance for losses on realization of assets of \$546 million is insufficient to provide for the overstatements of assets identified above. This allowance was established many years ago and is a general allowance for losses on all classes of assets. It does not constitute a provision for loss related to any specific asset or class of assets, even though Section 54 of the Financial Administration Act provides a means for establishing an adequate allowance. Furthermore, departments are not required to identify delinquent loans and advances for purposes of assessing the adequacy of this allowance.

The Accounting Entity

The accounting entity of the Government of Canada includes government departments and Crown corporations listed in Schedules A and B of the Financial Administration Act. The financial operations of these organizations are reflected in the financial statements of the Government of Canada on the basis of the Government's stated accounting policies. Crown corporations listed in Schedules C and D of the Act are excluded from the accounting entity as are all other government-owned and controlled enterprises not listed in Schedules to the Act. Thus, their financial Operations, assets and liabilities are not reflected in the financial statements of the Government. The rationale for excluding these organizations is that they are engaged in activities fundamentally different from those of government departments.

In 1976, my Office studied the budgetary and accounting consequences of the classification of Crown corporations of which I am the auditor. This study covered a number of significant corporations named in Schedules C and D, including the National Harbours Board and the St. Lawrence Seaway Authority. The study concluded that differences between many of these corporations and government departments and agencies are more matters of form than substance. Most of the corporations studied engage in operations subject to significant non-commercial considerations, depend on parliamentary appropriations or other forms of governmental financial assistance for their continued existence, or carry out regulatory or other government-type activities. Thus the definition of the government accounting entity is based on a questionable premise concerning the nature of the activities of the corporations studied. Accordingly, in my 1976 Report I recommended that:

Crown corporations which carry on government-type activity, or are financially dependent on the public purse, should be included in the Government of Canada accounting entity:

- to be consistent with the basic concept of segregating governmental from commercial activities undertaken under the auspices of the Government; and
- to provide for more informative disclosure of summary information in the Estimates and in the Public Accounts so that these documents display consistently all government-type activities financed out of the public purse.

Exclusion from the government accounting entity of such corporations results in inconsistencies in the recording of assets and budgetary expenditures. Similar transactions for similar purposes are recorded as assets in some circumstances and as budgetary expenditures in others.

For example, the National Harbours Board operates ports and related facilities; similarly, the Airports Revolving Fund of the Department of Transport operates airports and related facilities. Loans to both the Revolving Fund and the Board were used to finance the acquisition of fixed assets. Loans to the Revolving Fund are to be written off because they are not loans to an organization outside the government accounting entity. In contrast, loans to the Board continue to be reported as assets of the Government because the Board is considered to be an outside organization. If the Board were included in the accounting entity, the reported value of the Government's loans would be substantially reduced.

The St. Lawrence Seaway Authority operates a deep waterway system between the Port of Montreal and Lake Erie and is another example of a Crown corporation that carries on a

government-type activity but is excluded from the accounting entity. If the Authority were included, the value of the Government's investment of \$625 million reported in the Statement of Assets and Liabilities would be reduced by approximately \$600 million representing, for the most part, the acquisition of fixed assets by the Authority. Fixed assets relating to the Welland Canal and non-toll canals were previously financed by budgetary appropriations of Canada and therefore are not reflected in the Government's investment. Accordingly, some of the fixed assets of the Seaway are indirectly shown as assets in the accounts of Canada and some are not.

At present, acquisitions of fixed assets by certain Schedule C and D corporations, financed through parliamentary appropriations, are recorded as budgetary expenditures in the accounts of Canada and not as assets. For example, this year the Canadian Broadcasting Corporation and the National Capital Commission received appropriations of \$64 million and \$37 million to finance fixed asset acquisitions. The use of budgetary appropriations to finance fixed asset acquisitions by all Schedule C and D corporations that carry on government-type activities and are financially dependent on the public purse would result in such acquisitions being reported in the accounts of Canada on a consistent basis.

The inconsistencies described in the foregoing arise because Crown corporations that carry on government-type activities and are financially dependent on the Government are treated as organizations outside the government accounting entity. As a result of these inconsistencies, the reported value of loans to and investments in such corporations is overstated in the accounts of Canada. (These loans and investments include certain amounts which are described below as being questionable on other grounds.)

Loans, Investments and Advances, the Reported Value of which is Questionable

A number of Crown corporations have a history of deficits and lack sufficient revenues to repay their indebtedness to Canada. The reported value of loans to and investments in the National Harbours Board of \$342 million, the St. Lawrence Seaway Authority of \$625 million and Atomic Energy of Canada Limited of \$358 million, totalling \$1,325 million, is questionable on these grounds.

The reported value of loans to developing countries and loans to and subscriptions in international development associations, amounting to \$2,490 million, is questionable since by their terms these loans and subscriptions have the characteristics of grants or contributions. Under the Government's stated accounting policies grants and contributions are recorded as budgetary expenditures rather than assets.

The National Harbours Board

The Government's reported investment in the National Harbours Board consists of loans and advances totalling \$342 million. At December 31, 1977, the Board reported an accumulated deficit of \$374 million, after providing for \$255 million of interest in arrears on these loans and on other government loans previously written off. The Board's inability to pay its interest and the size of its accumulated deficit indicate that the Board will not likely be able to repay its outstanding loans from the Government.

The St. Lawrence Seaway Authority

In previous years I reported that it was extremely unlikely that the St. Lawrence Seaway Authority would be able to repay its outstanding loans from Canada. At April 1, 1977, these interest-bearing loans of \$625 million, representing the Government's reported investment in the Authority, were converted to contributed capital and the recorded value of the investment remained unchanged in the accounts of Canada. The fact that the Authority has been unable to pay interest of \$210 million on these loans indicates the recorded value of the Government's investment remains questionable.

Atomic Energy of Canada Limited

At March 31, 1978, the Corporation reported an accumulated deficit of \$163 million. Since it appears at present that the Corporation is unlikely to generate sufficient income from its commercial operations to offset its accumulated deficit, the recorded value of the Government's investment of \$164 million of capital stock and contributed capital is questionable.

Included in the Government's loans to the Corporation is \$194 million related to the construction of the La Prade heavy water plant which will be deferred according to announcements by the Government subsequent to the year-end. This loan may require parliamentary appropriation for write-off.

During the year, loans of \$87 million respecting the prototype nuclear generating station at Gentilly, Quebec were written off as research expenditure and loans of \$70 million pertaining to the Douglas Point, Ontario nuclear station were converted to equity. These loans were questioned in my previous years' Reports.

Loans to developing countries

Loans to national governments include \$1,414 million in special loan assistance to developing countries. Most of these loans bear no interest and are repayable over 50 years with no payments falling due in the first 10 years. A certain number carry nominal interest rates of 3/4 of 1%. Loans for such long periods and with such low interest rates have the characteristics of grants or contributions, but are recorded as assets of the Government of Canada in conformity with the appropriation authorities which authorized them. During the year parliamentary approval was obtained to write off loans to least developed countries amounting to \$232 million previously reported in this category.

Subscriptions, loans and advances to international organizations reported as foreign assets include \$314 million of special loan assistance to international development associations. These loans have no repayment terms and bear no interest. Repayment will fall due only on termination of the associations. These loans also have the characteristics of grants.

In addition to these working capital advances, Canada's subscription to an international development association amounts to \$762 million. This association makes loans to developing countries on similar terms to those of the special loan assistance commented on previously.

Disclosure of Additional Information in the Audited Financial Statements

The Public Accounts contain extensive information, displayed in a variety of ways, pertaining to the financial position and operations of the Government of Canada. This

information can, for the most part, be summarized in the audited financial statements. The inclusion of additional audited statements, and the disclosure of additional information in the existing statements, would help provide the reader with a more complete and useful summary of the financial position and operations. The following paragraphs comment on additional statements and information which could be usefully included as part of the audited financial statements.

Statement of Source and Use of Financial Resources

The audited financial statements of the Government of Canada would be improved if they included a statement that displayed the sources and uses of the Government's financial resources in order to show how the Government finances its operations. Such a statement was envisaged in recommendation 6 of the Report of the Independent Review Committee on the Office of the Auditor General of Canada which stated that:

The Public Accounts should include among the main financial statements of Canada a new statement showing changes in financial position during the fiscal year and the causes of such changes.

The conventional Statement of Revenue and Expenditure is inadequate for this purpose since it does not show the impact on debt and bank balances of non-budgetary transactions such as those involving Crown corporations, foreign exchange reserves and the use of special accounts. The net changes in asset and liability balances displayed in the Statement of Assets and Liabilities lack focus of presentation for the reader and do little to disclose the causes of these changes.

Over the years a number of tables in various sections of the Public Accounts have shown this type of information. The Summary Statement of Transactions in Section 1 of this volume together with supporting tables is an example. However, a summary statement that adequately explains changes in the Government's financial position is not included as an audited financial statement.

Summary of Use of Non-Budgetary Appropriations for Loans, Investments and Advances

The audited financial statements provide a comparison of budgetary expenditure with related appropriation authority in the Summary of Budgetary Appropriations, Expenditures and Unexpended Balances by Department. Both the Report on the Study of the Accounts of Canada and the Report of the Independent Review Committee on the Office of the Auditor General of Canada recommended that the Public Accounts include a similar comparison of non-budgetary expenditure with related appropriation authority. A Summary of Use of Non-Budgetary Appropriations by Department for Loans, Investments and Advances was developed this year and is included in Section 9 of this volume. The Government has advised that such a summary will be included with the 1979 financial statements of the Government to be submitted for audit.

Significant commitments

The audited statements would be improved if they disclosed, in summary form, major commitments related to future expenditure such as those resulting from contractual obligations under long-term leases, agreements to purchase capital assets and agreements related to Canada's activity in the international financial community. Many of these commitments are of

financial significance. For example, the Government has agreed to purchase, when called upon, shares in various international development banks for an aggregate consideration of \$1,448 million and make additional loans to developing countries of \$680 million.

Implementation of Recommendations of the Study of the Accounts of Canada

The Report of the Study of the Accounts of Canada was tabled in the House of Commons on January 30, 1976, and referred to the Standing Committee on Public Accounts. In its Fifth Report, tabled on March 9, 1976, the Committee endorsed the 41 recommendations of the Study and recommended that the Treasury Board implement them as soon as it was technically possible to do so. Since that date a number of the Study's recommendations have been implemented and some action has been initiated on most others. The Financial Administration Branch of the Office of the Comptroller General of Canada has the responsibility for ensuring that the recommendations are implemented. The following comments relate to significant recommendations which are not yet implemented.

- Parliamentary authority has not yet been sought to delete "Accounts Internal to the Government" from the accounts of Canada as recommended in the Study. As mentioned previously, failure to delete these balances significantly overstates the Government's reported assets.
- Formal procedures have been developed to provide for the recording of all accounts payable for expenditures under annually lapsing appropriations, as recommended in the Study. Last year, I reported that the Branch intended to implement such procedures at March 31, 1978. The Branch now advises that these procedures will not be implemented until March 31, 1980, at the earliest.
- The Branch advises that work has started on a special study on the valuation of assets, but that this project may take some time to complete and implement. As reported last year, this study will facilitate implementation of recommendations concerning the establishment of provisions for losses on specific classes of assets.
- Procedures have been developed, and instructions to departments have been formalized, to quantify revenue internal to the Government. This information is presented in Section 4 of this volume, but is not reflected in the Statement of Revenue and Expenditure as recommended by the Study.
- The Program Branch of the Treasury Board Secretariat has instituted a project on revision of the form of the Estimates which will consider, among other issues, recommendations of the Study concerning the presentation of summary information in the Estimates. It is not expected that these recommendations will be fully implemented before 1980-81.
- A revised Treasury Board policy related to the Study's recommendations concerning revolving funds and cost recovery is expected to be available by December 31, 1978, with implementation planned for the year ended March 31, 1980. A revised policy on commitment accounting is expected by March 31, 1979.

The implementation of these recommendations has not progressed in accordance with the timetable that I was advised of and reported on last year. A number of completion dates have been postponed and much remains to be done. My Office will continue to monitor and report on the progress in implementing the recommendations of the Study.

1978 Report of the Auditor General of Canada – Appendix D

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX D</H1>

</CENTER>

<HR>

IMPROVING THE FINANCIAL INFORMATION PARLIAMENT RECEIVES - ILLUSTRATIVE ESTIMATES FOR AGRICULTURE

INTRODUCTION

1. The Estimates for Agriculture cover:

A - Department

B - Canadian Dairy Commission

C - Canadian Livestock Feed Board

D - Farm Credit Corporation

2. The Department itself has five programs: (1) Food Production and Marketing; (2) Research; (3) Health of Animals; (4) Canadian Grain Commission; and (5) Administration.

3. The Estimates now include the following information, presented in a standardized form for each program:

- a Vote summary;
- a table showing the program subdivided into activities;
- a narrative statement of program objectives and a program description; and
- four tables giving program details by objects of expenditure, by manpower, by major capital projects and by grants and contributions.

4. The illustrative exhibits contained in this Appendix cover only part of the total activities. The illustrations include: (1) a Department-wide summary for Agriculture (the Department and the three agencies), (2) the program information for one departmental program (Health of Animals) at both the summary and detail levels, (3) the Estimates for the Canadian Dairy Commission, and (4) the Estimates for Farm Credit Corporation. Illustrations of the remaining departmental programs and of the Canadian Livestock Feed Board are not included.

5. **Summary for Agriculture.** The summary provides the broad ministry-wide highlights and overview needed to place the activities proposed for 1978-79 in a proper context. The section includes the general summary of the appropriations, as in the present Estimates, combined with a narrative and tabular analysis of major changes in the estimated expenditures and manpower of the ministry.

6. **Agriculture Canada, Departmental Program Presentation.** The principal features of the program presentation, which cover only one of the Department's programs, that are carried out by the Health of Animals Branch, are:

- disclosure of the Estimates at two distinct levels of detail - first, summary comments and analysis at the program level; second, supporting detailed analysis at the activity, sub-program or responsibility centre levels, as appropriate. Most details on activities and responsibilities are not available in the present Estimates and have been added to help understand what makes up the Branch's program.
- emphasis on total program costs, both voted and statutory, including an allocation of the cost of employee benefit plans and the imputed costs of services and accommodation provided without charge. In addition, receipts are allocated to the applicable activities and responsibility centres and deducted in arriving at total costs. The division of expenditures into operating, capital, and grants and contributions is not disclosed below the program level. This emphasis on total costs is suggested as a means of focusing better attention on the complete financial dimensions of a program or activity.
- disclosure of the basis of financial control. Greater emphasis has been devoted to presenting responsibility centre data to focus attention on how the Branch is organized to accomplish its objectives.
- less standardized form. To reflect the varied characteristics of each program, sub-program or activity, the form of presentation is not standardized. Narratives are used extensively to describe the nature of the activities and also to highlight critical features, explain major changes and present indicators of performance.

7. The Department encountered a number of practical problems in providing my Office with financial data for inclusion in our exhibits. Most related to the allocation of costs and revenues to activities and sub-activities. A decision to use an approach similar to that presented in the following pages will require agreement on how to allocate common costs like accommodation to responsibility centres and to activities and sub-activities. In addition certain data can be estimated for regions only on a probability basis - for example, the contributions relating to the Animal Contagious Diseases activity can be divided among regions on the basis of historic trends but actual allocations will obviously respond to the actual incidence and location of disease. Finally the Department expressed concern about the difficulties they believed they would encounter in reflecting decisions about salary levels and price changes in the details for responsibility and sub-activity levels within the time frames contained in present Treasury Board practices for processing the Estimates.

8. **Estimates of the Farm Credit Corporation.** These illustrative estimates incorporate many of the features of the program example for Health of Animals. The financial requirements

of the Farm Credit Corporation, like many other Crown corporations, are now included in the Estimates only when the Corporation's costs exceed revenues and there is a need for Parliament to appropriate funds to cover the resulting deficit. Even then only limited information is provided. The exhibits presented in the following pages are designed to portray a total picture, the most significant features of which are the inclusion of a narrative description of operations and highlights, the extensive use of indicators of performance, such as the percentage of loans in good standing, and the presentation of the full operating budget (revenues and expenses) in lieu of providing data only on the net loss.

9. **Estimates of the Canadian Dairy Commission.** This example departs markedly from the present Estimates by:

- focusing on total program costs, determined on an accrual basis (as is used in the Commission's audited financial statements), instead of cash costs;
- showing the full funding of its activities, not merely that portion provided by appropriation;
- expanding the description of activities to reveal what makes up the content of the Program;
- eliminating unnecessary standardization in the tables on man-power and objects of expenditure;
- providing narrative explanations of highlights of the dairy program and of major changes in expenditure levels; and
- giving financial and statistical indicators of activity.

10. In summary the illustrations shown in the following pages are restricted to information about:

- the Department as a whole;
- one of the Department's five programs;
- the Canadian Dairy Commission; and
- the Farm Credit Corporation.

The patterns shown, however, could be applied to the remaining programs and components of Agriculture Canada.

ESTIMATES, 1978-79

AGRICULTURE

Table of Contents

	Page
MINISTRY	
General Summary	00
Summary by Vote	00
A - DEPARTMENT - HEALTH OF ANIMALS PROGRAM	
Table of Contents	00
B - CANADIAN DAIRY COMMISSION	
Table of Contents	00
C - CANADIAN LIVESTOCK FEED BOARD	
Table of Contents	00
D - FARM CREDIT CORPORATION	
Table of Contents	00

ESTIMATES, 1978-79

AGRICULTURE

General Summary

The Minister of Agriculture is responsible for the Department, which consists of five programs, and for the agencies listed below:

Canadian Dairy Commission

Canadian Livestock Feed Board

Farm Credit Corporation

<u>Estimates</u>								
					<u>Man-Years</u>			
	<u>Budgetary</u> <u>(\$ millions)</u>		<u>Non-Budgetary</u> <u>(\$ millions)</u>		<u>Controlled</u>		<u>Other</u>	
	<u>1978-79</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1977-78</u>
Department	726.5	693.0	4.0	5.0	11,294	11,242	-	-
Canadian Dairy Commission	3.0	1.7	-	-	59	50	-	-
Canadian Livestock Feed Board	12.3	10.9	-	-	24	24	-	-
Farm Credit Corporation	<u>0.5</u>	<u>6.8</u>	<u>266.5</u>	<u>300.0</u>	<u>±</u>	<u>±</u>	<u>720</u>	<u>720</u>
TOTAL	<u>742.3</u>	<u>712.4</u>	<u>270.5</u>	<u>305.0</u>	<u>11,377</u>	<u>11,316</u>	<u>720</u>	<u>720</u>

A - DEPARTMENT

The basic aim for Agriculture Canada, within the framework of overall government collectives and in cooperation with provincial governments, is to develop and assist the Canadian agricultural and food system, so that it will provide for the needs of Canadians, for export markets, and for international aid commitments in a manner which assures:

- and
- (a) a dependable supply of safe, nutritious food at reasonable prices to consumers;
 - (b) equitable returns to producers and processors.

The Department employs approximately 11,000 people located in about 200 separate establishments. The physical plant comprises 1.5 million acres of land and more than 2,500 laboratory, farm and office buildings. Under the authority of some thirty statutes, the Department conducts research, grades and inspects farm products, prevents and controls diseases and pests of crops and livestock, and carries on a number of other activities designed to help solve production and marketing problems for the farmer. These activities are conducted under the five programs Administration, Research, Food Production and Marketing, Health of Animals and the Canadian Grain Commission.

The total amount of \$710.5 million to be approved for the Department results in a net increase from 1977-78, including Supplementary Estimates (A), of \$32.5 million or 4.7% made up as follows:

Operating expenditures - increase of	\$28.3 million or 9.9%
Capital expenditures - increase of	5.9 million or 31.6%
Grants and Contributions - decrease of	.7 million or 0.2%
Loans for Exhibition Buildings - decrease of	1.0 million or 20.0%
These changes can be explained as follows:	
(1) Operating expenditures	
- Increase of 8.8% in salary costs due to changes in pay scales, promotions and reclassifications	\$18.0 million
- Increase in contributions to Employee Benefits Plans	2.6 million
- Workload increase of 96 man-years in Health of Animals Program, 20 man-years in Food Production and Marketing and 10 man-years in the Administration	2.7 million
- Reduction of 49 man-years in the Canadian Grain Commission and 25 man-years for CANFARM in the Food Production and Marketing Program	(1.2 million)
- Non-pay costs associated with man-year growth	.7 million
- Other pay increases for overtime costs, retirement and severance pay, etc.	.3 million
- Economic price increases associated with goods and services	<u>5.2 million</u>

and other operating costs	
	\$28.3 million

The net increase of 52 authorized man-years includes:

- Increase of 92 man-years for animal testing, meat inspection and brucellosis eradication in Health of Animals Program;
- 9 man-years for increased farm and rural development, research and program coordination within the Policy and Economics activity of the Administration Program;
- 10 man-years for improving financial administration in the Administration, Food Production and Marketing and Health of Animals Programs;
- Reduction of 49 man-years due to a lesser requirement in Canadian Grain Commission; and Reduction of 25 man-years in the CANFARM operation.

(2) Capital expenditures	
New projects starting in 1978-79	
- Office-Laboratory Building, St. Jean, Que. (Research Program), total cost \$6.1 million	\$.5 million
- Dock and shiploading facility, Prince Rupert, B.C. (Canadian Grain Commission Program), total cost \$11.5 million	<u>3.2 million</u>
	3.7 million
Projects commenced in prior years requiring an increase (decrease) in expenditure level over previous year	
- Office-Laboratory Building, Kemptville, N.S. (Research Program)	4.0 million
- Laboratory, Lethbridge, Alta. (Health of Animals Program)	1.2 million
- Plant Growth Building, Saskatoon, Sask. (Research Program) completed in 1977-78	(2.0 million)
- Other Projects	<u>(1.0 million)</u>
	5.9 million
(3) Grants and Contributions	

-	Increase in Dairy Support program to \$278 million	16.0 million
-	Increase of expenditures under Feed Freight Assistance Adjustment Fund to \$9.7 million	5.3 million
-	Compensation as a result of crop losses caused by migratory waterfowl	3.0 million
-	Payment to producer organizations of interest charges under the Advance Payments for Crops Act	1.0 million
-	Additional compensation for animals slaughtered in accordance with the Animal Disease and Protection Act (principally for the brucellosis eradication program) to \$10 million	4.0 million
-	Other grants and contributions	<u>0.9 million</u>
		30.2 million
-	Decreased contributions to the provinces under the Crop Insurance Act from \$75.5 million	(5.5 million)
-	Elimination of payments to processors in respect of consumer subsidies on skim milk powder	(17.9 million)
-	Reduction in amount of assistance required in the construction of a grain terminal at Windsor, Ont. by the United Co-operatives of Ontario, from \$8.0 million	<u>(7.5 million)</u>
		(0.7 million)

(4) Loans

- A decrease of \$ 1 million in the Loan vote to finance the construction of multi-purpose exhibition buildings (\$5 million to \$4 million).

B - Canadian Dairy Commission

The Canadian Dairy Commission was established as a Crown agency in 1966. Its objective is to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality. The Commission carries on four activities: administration, marketing, dairy farm income maintenance, and product and market research and product promotion. The Commission's appropriation of \$1.0 million for 1978-79 covers the costs of the administration and the product and market research and product promotion activities. The costs of the other activities are funded by appropriation of the Department of Agriculture (\$278 million) and by producers levies.

The appropriation for the Canadian Dairy Commission administrative expenditures shows an increase of \$1.1 million to \$1.0 million. One million of the total is for a dairy products research program. The major increase is in personnel costs with an increase of nine man-years to handle the increased workload.

C - Canadian Livestock Feed Board

The Canadian Livestock Feed Board is a Crown agency, established under the Livestock Feed Assistance Act in 1967. Its objectives are to ensure: (a) the availability of feed grain in Eastern Canada and British Columbia, (b) the availability of adequate storage space in Eastern Canada, and (c) the reasonable stability and fair equalization of feed grain prices in Eastern Canada and in British Columbia.

The Board administers the Feed Freight Equalization Program under which a portion of the costs of transportation of feed grains is paid (Feed Freight Equalization Activity). The Act also stipulates that it is the duty of the Board to make a continuing study of feed grain requirements and availability in these areas, as well as to study and make recommendations to the Minister with respect to requirements for additional feed grain storage facilities in Eastern Canada. It is also the duty of the Board to advise the Government on all matters pertaining to the stabilization and fair equalization of feed grain prices to livestock feeders (Supply and Price Stability Activity).

The Canadian Livestock Feed Board expenditures for contributions in 1978-79 have increased by \$1.4 million to \$1.4 million to cover the reinstatement of feed freight assistance rates in British Columbia to their former level.

D - Farm Credit Corporation

The Farm Credit Corporation is a Crown agency established by the Farm Credit Act of 1959 as successor to the Canadian Farm Loan Board. Under the Farm Credit Act, it makes long-term mortgage loans to assist Canadian farmers in organizing viable farm businesses. It is also responsible for administering the Farm Syndicates Credit Act, whereby loans are made to groups or syndicates of three or more farmers for the joint purchase of machinery, buildings and installed equipment. The Corporation also acts as an agent of the Department of Agriculture in administering the Land Transfer Plan of the Small Farm Development Program.

The head office of the Corporation is at Ottawa and there are branch offices located at Kelowna, B.C.; Edmonton, Alta.; Regina, Sask.; Winnipeg, Man.; Toronto, Ont.; Ste Foy, Que.; and Moncton, N.B. The Moncton office serves the four Atlantic Provinces.

The estimated amount required by the Farm Credit Corporation for the operating loss in 1978-79 shows a decrease of \$6.3 million to \$.5 million due to the decrease in and stabilization of interest rates, which has now brought interest rates charged to borrowers more in line with rates paid by the Corporation to Canada.

The non-budgetary estimates have decreased by \$33.5 million which reflects a reduction of \$13.5 million due to an anticipated reduction in the demand for new loans to farmers as well as a \$20.0 million cut-back in advances to the Corporation by the Government during the year as part of its restraint program.

Summary by Vote

		<u>ESTIMATES</u>			<u>EXPENDITURES</u>		
<u>Vote No.</u>	<u>Program</u>	<u>To be Voted 1978-79</u>	<u>Voted 1977-78</u>	<u>Change*</u>	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Actual 1976-77</u>
		(thousands of dollars)					
	A - Department						
	<i>Food Production and Marketing Program</i>						
15	Operating expenditures	63,227	58,724	4,503	63,227	58,724	50,370
20	Grants and contributions	301,168	283,797	17,371	301,168	283,797	269,924
(S)	Contributions to the provinces under the Crop Insurance Act				70,000	75,500	56,456
(S)	Interest payments and guarantees under the Advance Payments for Crops Act				1,000	--	--
(S)	Grants to Agencies established under the Farm Products Marketing Agencies Act				200	200	
(S)	Contributions to employee benefit Plans				6,064	4,858	3,417
-	Appropriation not required for 1978-79		17,952	(17,952)	--	17,952	13,080
-	Race Track Supervision Revolving Fund (net)	<u> </u>	<u> </u>	<u> </u>	<u>(728)</u>	<u>(731)</u>	<u>(976)</u>
	Total Budgetary	364,395	360,473	3,922	440,931	440,300	392,271
L25	Loans to finance the construction of multi-purpose exhibition buildings	<u>4,000</u>	<u>5,000</u>	<u>(1,000)</u>	<u>4,000</u>	<u>5,000</u>	<u>697</u>

	Total Program	368,395	365,473	2,922	444,931	445,300	392,968
	<i>Research Program</i>						
5	Operating expenditures	99,078	90,611	8,467	99,978	90,611	79,218
10	Capital expenditures	11,174	7,751	3,423	11,174	7,751	10,256
(S)	Contributions to employee benefit Plans				9,776	8,963	6,270
	Total Program	110,252	98,362	11,890	120,028	107,325	97,744
	<i>Health and Animals Program</i>						
30	Operating expenditures	75,032	66,595	8,437	75,032	66,555	60,118
35	Grants and contributions	12,086	8,187	3,899	12,086	11,187	9,205
(S)	Contributions to employee benefit plans	—	—	—	<u>7,755</u>	<u>6,842</u>	<u>4,545</u>
	Total Program	87,118	74,792	12,336	94,873	84,584	73,868
	<i>Canadian Grain Commission Program</i>						
40	Operating expenditures	25,807	29,161	(3,354)	25,807	29,161	24,386
45	Capital expenditures	7,503	--	7,503	7,503	--	--
(S)	Salaries of the Commissioners				111	104	104
(S)	Salary of the Supervisor over the Winnipeg Commodity Exchange				42	40	40
(S)	Contributions to employee benefit plans	—	—	—	<u>2,567</u>	<u>2,460</u>	<u>1,810</u>
	Total Program	33,310	29,161	4,149	36,030	31,765	26,340
	<i>Administrative Program</i>						
1	Program expenditures	31,277	28,073	3,204	31,277	28,073	23,737
(S)	Minister of Agriculture - Salary and Motor Car				22	22	22

	Allowance						
(S)	Contributions to employee to benefit plans	<u> </u>	<u> </u>	<u> </u>	<u>2,679</u>	<u>3,162</u>	<u>2,303</u>
	Total Program	<u>31,277</u>	<u>28,073</u>	<u>3,204</u>	<u>33,978</u>	<u>31,257</u>	<u>26,062</u>
	Summary						
	Total Budgetary	626,352	590,851	35,501	725,840	695,231	614,285
	Total Non-Budgetary	<u>4,000</u>	<u>5,000</u>	<u>(1,000)</u>	<u>4,000</u>	<u>5,000</u>	<u>697</u>
		<u>630,352</u>	<u>595,851</u>	<u>34,501</u>	<u>729,840</u>	<u>700,231</u>	<u>614,982</u>
	B - Canadian Dairy Commission						
50	Program expenditures	<u>2,951</u>	<u>1,700</u>	<u>1,251</u>	<u>2,951</u>	<u>5,918</u>	<u>1,849</u>
	C - Canadian Livestock Feed Board						
55	Operating expenditures	908	885	23	908	885	680
60	Grants and contributions	<u>11,400</u>	<u>10,000</u>	<u>1,400</u>	<u>11,400</u>	<u>10,000</u>	<u>12,050</u>
	Total Program	<u>12,308</u>	<u>10,885</u>	<u>1,423</u>	<u>12,308</u>	<u>10,885</u>	<u>12,730</u>
	D - Farm Credit Corporation						
65	Operating loss	<u>500</u>	<u>6,800</u>	<u>(6,300)</u>	<u>500</u>	<u>900</u>	<u>959</u>
	Total Budgetary	500	6,800	(6,300)	500	900	959
(S)	Loans for lending to farmers				266,200	298,600	267,351
(S)	Loans for lending to farm syndicates	<u> </u>	<u> </u>	<u> </u>	<u>300</u>	<u>(700)</u>	<u>(870)</u>
	Total Non-Budgetary	<u> </u>	<u> </u>	<u> </u>	<u>266,500</u>	<u>297,900</u>	<u>266,481</u>
	Total Program	<u>500</u>	<u>6,800</u>	<u>(6,300)</u>	<u>267,000</u>	<u>298,800</u>	<u>267,440</u>

*Bracketed figures in the "Change" column are decreases.

ESTIMATES, 1978-79

AGRICULTURE

A - Department - Health of Animals Program

Table of Contents

	Page
Analysis of Program	
Program Narrative -	
Aim	00
Objectives	00
Activities	00
Program Highlights	00
Summary by Vote	00
Summary of Total Cost of Program	00
Summary by Activity	00
Summary by Object of Expenditure	00
Summary of Contributions	00
Manpower by Activity	00
Manpower by Category and Group	00
Change in Man-years by Category	00
Organization Chart	00
Analysis of Activities	
Meat Inspection	
Narrative	00
Total Cost and Manpower by Responsibility Centre	00
Total Cost and Manpower by Sub-Activity	00

Animal Contagious Diseases

Narrative	00
Total Cost and Manpower by Responsibility Centre	00
Total Cost and Manpower by Sub-Activity	00

Animal Pathology

Narrative	00
Total Cost and Manpower by Responsibility Centre	00
Total Cost and Manpower by Sub-Activity	00
Major Capital Projects	00

Administration

Narrative	00
Total Cost and Manpower by Sub-Activity	00

Field Directorate and Support Services

Narrative	00
Total Cost and Manpower by Responsibility Centre	00

ESTIMATES, 1978-79

AGRICULTURE

A - Department - Health of Animals Program

Narrative

AIM

Within a framework of Departmental objectives and strategies, to provide veterinary, regulatory and scientific services which will assist the Canadian agricultural and food system to:

- (a) ensure consumers of a dependable supply of safe, nutritious and accurately labelled meat and meat food products;
- (b) increase the efficiency of livestock production; and
- (c) fully exploit the export potential of Canadian livestock and meat products.

OBJECTIVES

- To assist the livestock industry to develop and maintain a healthy livestock population.
- To assist the industry to fully exploit the export potential of Canada's livestock and meat products.
- To ensure consumers of a dependable supply of safe, nutritious and accurately labelled meat and meat food products.
- To provide a program of scientific services which will assist the livestock industry to reduce economic loss from animal disease.
- To administer, evaluate and control the programs and activities of the Branch as efficiently and effectively as possible.

ACTIVITIES

Meat Inspection - The registration and inspection of meat packing plants, the inspection of meat and meat food products, the review and approval of meat product labels, the establishment of meat standards, the surveillance of foreign packing plants and inspection of imported meat products, the certification of meat and meat products for export, and the provision of domestic inspection services through federal-provincial agreements.

Animal Contagious Diseases - Testing livestock for disease; establishment of control and eradication measures; certification of health of export livestock and livestock products; quarantine and examination of livestock and restricted commodities being imported.

Animal Pathology - Technical services in support of Meat Inspection and Animal Contagious Diseases activities including examination of meat and blood samples and disease specimens from livestock; research on animal diseases and meat quality; production of biologics (testing ingredients) in support of disease control and eradication programs and the provision of advisory services.

Administration - Branch executive, financial and administrative services, planning and evaluation, education and development, and support staff.

Field Directorate and Support Services - Administration of the field (regional) operations of the Meat Inspection and Animal Contagious Diseases activities.

PROGRAM HIGHLIGHTS

Meat Inspection

- 1 - Federally Registered Plants - The continued demand for federal inspection services will increase the number of federally registered slaughter and processing plants to over 480 from 448.
- 2 - Foreign Inspection Program - In order to ensure adequate protection to Canadian consumers, a program of routine foreign inspection visits has been developed. This will include plant inspection visits in the United States and other countries.
- 3 - Meat Inspection Regulations - To ensure adequate regulatory control over changing industrial conditions and trade practices, the Meat Inspection regulations have been revised and are to be published in 1978-79.
- 4 - Meat Safety - Increasingly, there is a need to meet consumers demands and foreign import requirements regarding food borne disease. The Meat Inspection Division will implement an epidemiological service in 1978-79. The objective of this service will be to develop a capability to monitor, control and eliminate food borne disease agents which may present a hazard for the health of domestic and foreign consumers.
- 5 - Meat Residues - Modern livestock production uses a number of potent substances as growth promoters and therapeutics, which can leave residual amounts in the meat if proper precautions are not observed. In addition, meat animals and meat products are exposed to ubiquitous agricultural and industrial pollutants as well as bacterial contamination. Consequently, the Meat Inspection Division is expanding its residue testing program to ensure the wholesomeness of meat products for consumer safety and foreign acceptance.
- 6 - Federal/Provincial Meat Inspection Program - To ensure the wholesomeness of Canada's meat supply, irrespective of the inspection agency involved, be it federal, provincial or municipal, national standards or norms are required. In 1978-79 federal and provincial authorities will collaborate to develop such norms for a variety of inspection functions.

Animal Contagious Diseases

- 1 - Brucellosis - The eradication of brucellosis is the number one priority of the Health of Animals Program. During 1977-78 Health of Animals officials met with representatives of the

dairy and beef industry, Canadian Veterinary Medical Association, and the directors of provincial veterinary services. As a result of the meetings, a new National Eradication Program was formulated and agreed upon. In 1978-79, a phased approach to Brucellosis Eradication will be fully implemented.

The new National Eradication Program will concentrate on the higher-incidence areas, as well as on the prevention of the spread of the disease by controlling movement of cattle between regions and within regions. New regulations will come into effect on April 1, 1978 which will significantly contribute to the eradication of brucellosis in Canadian cattle herds.

2 - Foreign Animal Diseases - Despite our favourable record in Canada last year (1977-78) the threat of a serious foreign animal disease gaining entry is still very real and to cope with this eventuality an emergency eradication task force will be established in Canada in 1978-79. The task force will consist of Health of Animals personnel who will be designated to be available on very short notice to form part of an emergency disease eradication force.

3 - Tuberculosis Eradication - The Animal Contagious Diseases Division will conduct a study to examine present detection and eradication procedures and make recommendations for the more efficient use of resources, while respecting the need for accreditation of areas for export purposes.

4 - Reportable and Other Diseases - Bovine Leukosis is causing increasing concern in Canada as well as in foreign countries. A number of European countries have launched eradication programs which include restrictive import policies for cattle and bovine semen. In 1978-79 the Animal Contagious Diseases Division will collaborate with other divisions to conduct a preliminary evaluation of the economic significance of bovine Leukosis in Canada. A study of Johne's Disease in Canada is also to be conducted to determine the adequacy of current policies and control programs and to make recommendations for associated improvements.

Animal Pathology

1 - Veterinary Research - In 1978-79 the Animal Pathology Division will conduct research to improve the specificity and efficiency of diagnostic tests for brucellosis. The Division will also conduct research to develop or improve diagnostic tests for foreign animal diseases, necessary to ensure the capability of foreign animal disease control and eradication. Research will also continue on salmonellosis to increase knowledge of sources and modes of contamination and of effective decontamination methods.

2 - Diagnostic Services - The Animal Pathology Division provides diagnostic and analytical services in support of the Meat Inspection and Animal Contagious Diseases Divisions, livestock and poultry industries and private veterinary practitioners. In this connection, it is expected that in 1978-79 the Animal Pathology Division will perform over three million diagnostic tests.

Administration

1 - Veterinary Staff Requirements - Through agreements between the Federal Government and the Provinces of Saskatchewan, Ontario and Quebec, veterinary teaching facilities are being expanded, to ensure that Canada's requirements for veterinary manpower will be met. Payments will be made towards the cost of construction at the University of Guelph, the University of Montreal and the University of Saskatchewan.

ESTIMATES, 1978-79

AGRICULTURE

A - Department - Health of Animals Program

<u>Summary by Vote</u>						
	<u>Estimates</u>			<u>Expenditures</u>		
	To be voted <u>1978-79</u>	Voted <u>1977-78</u>	<u>Change</u>	Estimated <u>1978-79</u>	Forecast <u>1977-78</u>	Actual <u>1976-77</u>
	\$	\$ (Note 1)	\$	\$ (Note 2)	\$ (Note 3)	\$
Budgetary						
Vote 30 - Health of Animals Operating expenditures	75,032,000	66,595,000	8,437,000	75,032,000	66,555,000	60,118,000
Vote 35 - Contributions, including compensation at rates determined in the manner provided by Section 12 of the Animal Disease and Protection Act to owners of animals affected with diseases coming under that Act that have died or have been slaughtered in circumstances not covered by the Act	12,086,000	8,187,000	3,899,000	12,086,000	11,187,000	9,205,000
Statutory - Contributions to employee benefit plans	_____	_____	_____	<u>7,755,000</u>	<u>6,842,000</u>	<u>4,545,000</u>
TOTAL PROGRAM	<u>87,118,000</u>	<u>74,782,000</u>	<u>12,336,000</u>	<u>94,873,000</u>	<u>84,584,000</u>	<u>73,868,000</u>

Notes

1. Includes Supplementary Estimates (A).
2. Identical to 1978-79 Estimates.
3. Includes anticipated Supplementary Estimates (B).

<u>Summary of Total Cost of Program</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
	\$	\$	\$	\$
Amount to be voted	87,118	77,742	9,376	69,323
Statutory	<u>7,755</u>	<u>6,842</u>	<u>913</u>	<u>4,545</u>
Total Program	94,873	84,584	10,289	73,868
Add: Services and accommodation provided without charge by this and other departments	4,132	3,112	1,020	3,331
Less: Revenues	<u>(5,618)</u>	<u>(3,675)</u>	<u>(1,943)</u>	<u>(5,137)</u>
Total Cost of Program	<u>93,387</u>	<u>84,021</u>	<u>9,366</u>	<u>72,062</u>

<u>Summary of Activity</u>				
(thousands of dollars)				
	<u>Total Cost of Program</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
	\$	\$	\$	\$
Meat Inspection	38,885	34,595	4,290	30,127
Animal Contagious Diseases	34,304	33,332	972	28,149

Animal Pathology	14,510	11,791	2,719	10,400
Administration	3,463	2,332	1,131	1,452
Field Directorate and Support Services	<u>2,225</u>	<u>1,971</u>	<u>254</u>	<u>1,934</u>
Total Cost of Program	<u>93,387</u>	<u>84,021</u>	<u>9,366</u>	<u>72,062</u>

<u>Summary by Object of Expenditure</u>				
(thousands of dollars)				
	<u>Total Cost of Program</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
	\$	\$	\$	\$
Personnel	<u>67,856</u>	<u>60,343</u>	<u>7,513</u>	<u>53,039</u>
Goods and services:				
Transportation and communications	3,352	2,886	466	2,631
Professional and special services	3,307	3,221	86	3,490
Utilities, materials and supplies	4,127	3,537	590	3,429
Other	<u>695</u>	<u>637</u>	<u>58</u>	<u>648</u>
Total	<u>11,481</u>	<u>10,281</u>	<u>1,200</u>	<u>10,198</u>
Capital:				
Construction and acquisition of land, buildings and equipment	2,280	1,570	710	447
Construction and acquisition of machinery and equipment	<u>1,170</u>	<u>1,203</u>	<u>(33)</u>	<u>979</u>
Total	<u>3,450</u>	<u>2,773</u>	<u>677</u>	<u>1,426</u>
Contributions	<u>12,086</u>	<u>11,187</u>	<u>899</u>	<u>9,205</u>

Total Program	<u>94,873</u>	<u>84,584</u>	<u>10,289</u>	<u>73,868</u>
Add: Services provided by other Departments	3,596	2,646	950	2,802
Accommodation provided by this Department	<u>536</u>	<u>466</u>	<u>70</u>	<u>529</u>
Total	<u>4,132</u>	<u>3,112</u>	<u>1,020</u>	<u>3,331</u>
Less: Revenues -				
Overtime inspection services	3,420	2,867	553	2,672
Federal/Provincial meat inspection services	433	343	90	58
Quarantine and inspection charges	1,518	218	1,300	1,815
Proceeds from sales and other fees	<u>247</u>	<u>247</u>	=	<u>592</u>
Total	<u>5,618</u>	<u>1,675</u>	<u>1,943</u>	<u>5,137</u>
Total Cost of Program	<u>93,387</u>	<u>84,021</u>	<u>9,366</u>	<u>72,062</u>

<u>Summary of Contributions</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
	\$	\$	\$	\$
<u>Contributions</u>				
Administration				
Canada's fee for membership in the Office International des Épizooties	17	17	--	15
Payments, in accordance with agreements entered into with	1,836	972	864	51

the Provinces of Ontario, Quebec and Saskatchewan towards the costs of construction of additions or enlargements to veterinary science teaching facilities at the Universities of Guelph, Montreal at St. Hyacinthe and Saskatchewan at Saskatoon				
Canadian Veterinary Medical Association	3	3	-	2
	<u>1,856</u>	<u>992</u>	<u>864</u>	<u>68</u>
Animal Contagious Diseases				
Compensation for animals slaughtered in accordance with the terms of the Animal Disease and Protection Act	10,000	10,000	--	8,802
Contributions to the provinces in accordance with Regulations of the Governor in Council, of amounts not exceeding two-fifths of the amounts paid by the provinces to owners of animals that have died as a result of rabies	100	100	--	84
Compensation at rates determined in the manner provided by Section 12 of the Animal Disease and Protection Act to owners of animals affected with diseases coming under that Act, that have died or have been slaughtered in circumstances not covered by the Act and Regulations made thereunder	120	60	60	82
Compensation under terms and conditions approved by the Governor in Council to owners of animals that have died as a result of anthrax	10	10	--	--

Items not required for 1978-79				
Compensation to producers for economic loss associated with the Bluetongue Quarantine Area in the South Okanagan area of British Columbia	--	25	(25)	163
Contribution towards the transformation, fittings and maintenance of the headquarters building of the Office International des Epizooties, Paris, France	--	--	--	6
	<u>10,230</u>	<u>10,195</u>	<u>35</u>	<u>9,137</u>
Total Contributions	12,086	11,187	899	9,205

Manpower by Activity <u>Man-Years and Continuing Employees</u>				
	<u>Man-years</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
Meat Inspection	1,560	1,509	51	1,397
Animal Contagious Diseases	716	698	18	680
Animal Pathology	391	387	4	378
Administration	34	34	--	44
Field Directorate and Support Services	<u>98</u>	<u>98</u>	--	<u>105</u>
Total Man-Years	<u>2,799</u>	<u>2,726</u>	<u>73</u>	<u>2,604</u>

	<u>Continuing Employees</u>			
				<u>Actual</u>

	Estimated March 31 <u>1979</u>	Forecast March 31 <u>1978</u>	<u>Change</u>	Sept. 30 <u>1977</u>	March 31 <u>1977</u>
Meat Inspection	1,576	1,528	48	1,466	1,365
Animal Contagious Diseases	692	683	9	650	619
Animal Pathology	381	380	1	380	340
Administration	34	34	--	31	36
Field Directorate and Support Services	<u>91</u>	<u>91</u>	=	<u>87</u>	<u>82</u>
Total Continuing Employees	<u>2,774</u>	<u>2,716</u>	<u>58</u>	<u>2,614</u>	<u>2,442</u>

	Manpower - Man-Years Authorized for 1978-79 <u>by Category and Group</u>					
		<u>ACTIVITY</u>				
	Total Man-Years <u>Authorized</u>	<u>Meat Inspection</u>	<u>Animal Contagious Diseases</u>	<u>Animal Pathology</u>	<u>Admin- istration</u>	Field Directorate and Support <u>Services</u>
Executive	<u>1</u>	=	=	=	<u>1</u>	=
Scientific and Professional						
Veterinary Sciences	665	346	272	33	7	7
Scientific Research	46	--	--	46	--	--
Others	<u>9</u>	<u>1</u>	=	<u>8</u>	=	=
	<u>720</u>	<u>347</u>	<u>272</u>	<u>87</u>	<u>7</u>	<u>7</u>
Administrative and Foreign Services	<u>31</u>	<u>2</u>	<u>3</u>	<u>5</u>	<u>12</u>	<u>9</u>

Technical						
Primary Products Inspection	1,451	1,171	280	--	--	--
Engineering and Scientific Support	<u>168</u>	--	--	<u>168</u>	--	--
	<u>1,619</u>	<u>1,171</u>	<u>280</u>	168	--	--
Administrative Support						
Clerical and Regulatory	250	34	127	26	7	56
Secretarial, Stenographic and Typing	<u>54</u>	<u>6</u>	<u>7</u>	<u>8</u>	<u>7</u>	<u>26</u>
	<u>304</u>	<u>40</u>	<u>134</u>	<u>34</u>	<u>14</u>	<u>82</u>
Operational						
General Labour and Trades	88	--	27	61	--	--
Others	<u>36</u>	--	--	<u>36</u>	--	--
	<u>124</u>	--	<u>27</u>	<u>97</u>	--	--
Total of Man-Years Authorized	<u>2,799</u>	<u>1,560</u>	<u>716</u>	<u>391</u>	<u>34</u>	<u>98</u>

(Chart not available, see annual Report)

(Chart not available, see annual Report)

ACTIVITY: MEAT INSPECTION

Narrative

The responsibilities are to:

- Administer the Meat Inspection Act and Regulations, Humane Slaughter of Food Animals Act and Humane Slaughter Regulations and relevant sections of the Animal Disease and Protection Act and Regulations and Food and Drugs Act and Regulations.
- Ensure that meat and meat food products meet Canadian standards and the import standards of foreign countries.

This activity is executed through the Meat Inspection Division's Ottawa Headquarters and seven regional offices. It comprises the sub-activities of Meat Inspection Management and Administrative Services, Red Meat Inspection, Processing Inspection, Poultry, Rabbits, Game Inspection and Canning Inspection.

At the operational level, inspection services ensure the compliance of meat products and packing plants to the prescribed standards and regulations. In registered establishments, which include red meat, poultry, rabbits and game slaughter plants, all animals receive an ante-mortem inspection to detect diseases that would make them unfit for food. A post-mortem inspection is also carried out to determine the health status of each animal carcass. Similar services are provided to domestic plants under federal-provincial agreements for which the government is reimbursed. Inspection also extends to processing, canning and rendering operations. All ingredients going into meat food products are examined to ensure that no adulteration takes place. Plants, manufacturing methods and equipment are inspected to ensure hygienic practice. Carcasses and portions found unfit for food are condemned and destroyed under supervision. The geographical distribution of inspected establishments is nation wide, and as of March 31, 1977, included 812 plants (federally inspected, federally registered (domestic) and rendering plants).

Key Factors (1978-79):

- Manpower represents 94% of the total cost of the activity.
- Revenues of the activity are \$1,857,000, principally the recovery of overtime costs from meat packers.
- The man-years authorized are basically for veterinary science personnel (146) and primary product inspectors (1,171) representing 97% of the total man-years in the activity.

Performance Indicators:

Manpower utilization in this activity is a function of many variables, such as: type of commodity and volume of throughput, number of lines and shifts, condition of animals, physical plant layout, etc. The following represents one indicator of slaughter inspection efficiency, an element which represents 69% of the total man-years of the activity.

	<u>1974-75</u>	<u>1975-76</u>	<u>1976-77</u>	<u>1977-78</u>	<u>1978-79</u>
	Actual	Actual	Actual	Forecast	Forecast

Output - billions of pounds of inspected slaughter	4.1	4.0	4.4	4.6	4.8
Input - Man-years utilized in Red Meat and Poultry slaughter plants	913	934	993	1039	1078
Efficiency - millions of pounds of inspected slaughter per man-year	4.490	4.375	4.575	4.425	4.5

(Graphs not available, see annual Report)

Total Cost and Manpower by Responsibility Centre				
	<u>Expenditures</u>			
	<u>Estimated 1978-79</u> (\$000)	<u>Forecast 1977-78</u> (\$000)	<u>Change from 1977-78</u> (%)	<u>Actual 1976-77</u> (\$000)
HEADQUARTERS				
Operating Costs	1,902	1,400	36	956
Revenues	(4)	(4)	--	--
Total Cost	<u>1,898</u>	<u>1,396</u>	36	<u>956</u>
Man-Years	54	52	4	33
<u>REGIONAL OFFICES:</u>				
ATLANTIC PROVINCES				
Operating Costs	2,407	2,118	13	1,877
Revenues	(140)	(108)	30	(115)
Total Cost	<u>2,267</u>	<u>2,010</u>	13	<u>1,762</u>
Man-Years	92	87	6	82
QUEBEC				
Operating Costs	11,817	10,674	11	9,210

Revenues	<u>(1,250)</u>	<u>(959)</u>	30	<u>(889)</u>
Total Cost	<u>10,567</u>	<u>9,715</u>	9	<u>8,321</u>
Man-Years	426	414	3	382
ONTARIO				
Operating Costs	11,934	10,551	13	9,469
Revenues	<u>(1,338)</u>	<u>(1,182)</u>	13	<u>(1,166)</u>
Total Cost	<u>10,596</u>	<u>9,369</u>	13	<u>8,303</u>
Man-Years	418	401	4	384
MANITOBA				
Operating Costs	3,838	3,353	14	2,997
Revenues	<u>(270)</u>	<u>(235)</u>	15	<u>(205)</u>
Total Cost	<u>3,568</u>	<u>3,118</u>	14	<u>2,792</u>
Man-Years	145	142	2	125
SASKATCHEWAN				
Operating Costs	2,034	1,757	16	1,689
Revenues	<u>(130)</u>	<u>(107)</u>	21	<u>(92)</u>
Total Cost	<u>1,904</u>	<u>1,650</u>	15	<u>1,597</u>
Man-Years	79	80	(2)	81
ALBERTA				
Operating Costs	5,931	5,515	7	4,908
Revenues	<u>(409)</u>	<u>(311)</u>	31	<u>(281)</u>
Total Cost	<u>5,522</u>	<u>5,204</u>	6	<u>4,627</u>
Man-Years	233	226	3	220
BRITISH COLUMBIA				
Operating Costs	2,879	2,441	18	1,971

Revenues	<u>(316)</u>	<u>(308)</u>	2	<u>(202)</u>
Total Cost	<u>2,563</u>	<u>2,133</u>	20	<u>1,769</u>
Man-Years	113	107	6	90
Total Cost of Activity	<u>38,885</u>	<u>34,595</u>	12	<u>30,127</u>
Total Man-Years	1,560	1,509	3	1,397

Explanations of Major Changes:

Man-Years: Increase of 51 man-years is the result of the approval of a Supplementary Estimate in 1977-78 with a carry-over effect in 1978-79 for the provision of:

(i) 19 man-years for the purpose of providing meat inspection services under the Domestic Meat Inspection Program.

(ii) 32 man-years for the purpose of providing additional inspection services to meet increased slaughter volume and to increase the number of shifts when longer hours of operations are required by plants.

<u>Total Cost and Manpower by Sub-Activity</u>					
<u>Sub-Activities</u>	<u>Man-Years</u>	<u>Expenditures</u>			
		<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Increase (Decrease)</u>	<u>Actual 1976-77</u>
		(thousands of dollars)			
Red Meat Inspection	772	17,934	16,363	1,571	14,051
Processing Inspection	389	10,209	8,943	1,266	6,914
Poultry, Rabbits, Game Inspection	306	6,973	6,154	819	6,227
Meat Inspection Management and Administrative Services	70	2,291	2,022	269	1,763
Canning Inspection	<u>23</u>	<u>676</u>	<u>593</u>	<u>83</u>	<u>525</u>
Total Activity	1,560	38,083	34,075	4,008	29,480
Add: Services and Accommodation provided	—	<u>802</u>	<u>520</u>	<u>282</u>	<u>647</u>

without charge					
Total Cost of Activity	<u>1,560</u>	<u>38,885</u>	<u>34,595</u>	<u>4,290</u>	<u>30,127</u>

Explanations of Major Changes:

- Man-Years: The increase of 51 man-years is distributed between federally inspected and non-federally registered (domestic) red meat, poultry and processing plants.
- Cost: Increase of \$4,290,000 is a result of -

(1) six per cent salary increases for promotion, overtime and collective bargaining agreements and contributions to employee benefit plans	\$ 2,717,000
(2) salaries for 51 additional man-years	1,718,000
(3) support costs related to additional man-years and operations	478,000
(4) increase in revenues	<u>(643,000)</u>
	<u>\$ 4,290,000</u>

ACTIVITY: ANIMAL CONTAGIOUS DISEASES

Narrative

The responsibilities are to:

- administer the Animal Diseases and Protection Act and Regulations;
- prevent and control communicable animal diseases; control and eradication of reportage diseases; diagnosis and eradication of foreign animal diseases;
- control the importation of animals and animal products;
- prevent animal suffering and loss while in transit; and
- inspect, test and certify animals and animal products for export.

This activity is executed through its Ottawa Headquarters and seven regional offices and comprises the sub-activities of Contagious Diseases Management and Administrative Services, Program Eradication Emergency and Investigative Eradication, Quarantine, Port Inspection and In-transit Care of Animals. District Offices, which may be involved in a number of sub-activities,

are located at strategic points, usually in a geographic location with approximately 100,000 cattle.

Maximum security quarantine stations to hold and inspect livestock are operated at Mirabel, Edmonton, Levis and Grosse Île and the islands of St. Pierre and Miquelon. Seven quarantine stations and inspection facilities are located along the Canada-U.S.A. border. Offices are also maintained at all international airports and sea ports for the inspection of animals and restricted animal products.

Key Factors (1978-79):

- manpower represents \$16.9 million, or 49% of the total cost of the activity;
- contributions of \$10.2 million, 30% of the total cost of the activity, are reflected under "Program Eradication" as they relate to compensation for diseased animals;
- the total cost of the activity is reduced by estimated revenues of \$1.6 million, derived from port inspection and quarantine operations; and
- the man-years authorized are basically for veterinary services personnel (272), primary product inspectors (280) and administrative support staff (134)

Performance Indicators

Seventy-nine per cent of the Division's operating resources are allocated to the Program Eradication sub-activity. These resources support several disease prevention, surveillance, control and eradication programs. The following tables and charts illustrate the relationship between the growth in operating resources for this sub-activity and the increased number of field tests conducted for the major disease control and eradication programs.

	<u>1974-75</u>	<u>1975-76</u>	<u>1976-77</u>	<u>1977-78</u>	<u>1978-79</u>
	Actual	Actual	Actual	Forecast	Forecast
<i>Output -</i>					
Number of animals tested for Tuberculosis, Brucellosis and Johne's disease	1,637,238	2,029,648	2,756,986	3,090,774	3,379,950
<i>Input -</i>					
Operating Resources (\$000)	8,994	10,608	12,350	14,174	5,002
<i>Cost Ratio -</i>					
Number of animals tested per thousand dollars	182	191	223	218	225

(Charts not available, see annual Report)

Total Cost and Manpower by Responsibility Centre				
	<u>Expenditures</u>			
	Estimated <u>1978-79</u> (\$000)	Forecast <u>1977-78</u> (\$000)	Change from <u>1977-78</u> (%)	Actual <u>1976-77</u> (\$000)
HEADQUARTERS				
Operating Costs	2,155	1,686	28	1,093
Revenues	<u>(11)</u>	<u>(11)</u>	--	(3)
Total Cost	<u>2,144</u>	<u>1,675</u>	28	<u>1,090</u>
Man-Years	38	45	(16)	31
QUARANTINES				
Operating Costs	1,689	2,731	(38)	1,951
Revenues	<u>(1,380)</u>	<u>(205)</u>	573	<u>(1,802)</u>
Total Cost	309	<u>2,526</u>	(88)	149
Man-Years	27	29	(7)	28
<u>REGIONAL OFFICES:</u>				
ATLANTIC PROVINCES				
Operating Costs	1,574	1,452	8	1,279
Contributions	23	23	--	30
Revenues	<u>(5)</u>	<u>(3)</u>	--	<u>(4)</u>
Total Cost	<u>1,592</u>	<u>1,472</u>	8	<u>1,305</u>
Man-Years	58	60	(3)	56

QUEBEC				
Operating costs	4,222	3,690	14	3,616
Contributions	1,936	1,926	1	1,626
Revenues	<u>(48)</u>	<u>(6)</u>		<u>(29)</u>
Total Cost	<u>6,110</u>	<u>5,610</u>	9	<u>5,213</u>
Man-Years	129	129	--	130
ONTARIO				
Operating Costs	6,689	5,767	16	5,218
Contributions	4,027	4,005	1	3,266
Revenues	<u>(75)</u>	<u>(20)</u>	--	<u>(58)</u>
Total Cost	<u>10,641</u>	<u>9,752</u>	9	<u>8,426</u>
Man-Years	196	173	13	172
MANITOBA				
Operating Costs	1,831	1,605	14	1,423
Contributions	1,224	1,216	1	970
Revenues	<u>(6)</u>	<u>(2)</u>	--	<u>(4)</u>
Total Cost	<u>3,049</u>	<u>2,819</u>	8	<u>2,389</u>
Man-Years	48	48	--	48
SASKATCHEWAN				
Operating Costs	2,376	2,127	12	2,013
Contributions	1,298	1,289	1	1,105
Revenues	<u>(5)</u>	<u>(2)</u>	--	<u>(4)</u>
Total Cost	<u>3,669</u>	<u>3,414</u>	7	<u>3,114</u>
Man-Years	71	72	(1)	67
ALBERTA				

Operating Costs	3,377	2,851	18	2,795
Contributions	1,419	1,410	1	947
Revenues	<u>(11)</u>	<u>(4)</u>	--	<u>(7)</u>
Total Cost	<u>4,785</u>	<u>4,257</u>	12	<u>3,735</u>
Man-Years	95	89	7	95
BRITISH COLUMBIA				
Operating Costs	1,719	1,486	16	1,557
Contributions	303	326	(7)	1,185
Revenues	<u>(17)</u>	<u>(5)</u>	--	<u>(14)</u>
Total Cost	<u>2,005</u>	<u>1,807</u>	11	<u>2,728</u>
Man-Years	54	53	2	53
Total Cost of Activity	34,304	33,332	3	28,149
Total Man-Years	716	698	3	680

Explanations of Major Changes:

Man-Years: The increase of 18 man-years is attributable to the manpower required to monitor the new livestock importation regulations of the United States on Canadian cattle; and to regulate and inspect artificial insemination centres in Canada involved in animal embryos and artificial insemination and the exportation of sperm.

<u>Total Cost and Manpower by Sub-Activity</u>					
<u>Sub-Activities</u>	<u>Man-Years</u>	<u>Expenditures</u>			
		<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Increase (Decrease)</u>	<u>Actual 1976-77</u>
		(thousands of dollars)			
Program Eradication	511	27,146	24,848	2,298	22,620
Port Inspection	109	2,913	2,263	650	2,174
Contagious Diseases Management and	55	1,830	1,526	304	1,501

Administrative Services					
Quarantine	27	183	2,271	(2,088)	61
Emergency and Investigation Eradication	6	295	216	79	255
In-transit Care of Animals	<u>8</u>	<u>263</u>	<u>826</u>	<u>(563)</u>	<u>190</u>
Total Activity	716	32,630	31,950	680	26,801
Add Services and accommodation provided without charge	—	<u>1,674</u>	<u>1,382</u>	<u>292</u>	<u>1,348</u>
Total Cost of Activity	<u>716</u>	<u>34,304</u>	<u>33,332</u>	<u>972</u>	<u>28,149</u>

Explanations of Major Changes:

Cost: The increase in cost of \$972,000 results from

(1) salaries and wages	\$ 2,210,000
(2) other operating costs provided for the 18 additional man-years	165,000
(3) services provided without charge by other departments	292,000
(4) decrease in capital funds for completion of the construction of	
(a) Mirabel quarantine station	(520,000)
(b) garage and storage facilities at Grosse Île	(75,000)
(5) increase in the forecast revenues, principally from quarantines	<u>(1,100,000)</u>
	<u>\$ 972,000</u>

ACTIVITY: ANIMAL PATHOLOGY

Narrative

The responsibilities are to:

- Perform diagnostic services for Meat Inspection and Animal Contagious Diseases activities, in connection with their statutory obligations and for livestock owners, provincial agencies and veterinarians.
- Conduct research studies on economically important animal diseases.
- Produce biologics (testing ingredients) and reagents to diagnose diseases under the statutory control of the Animal Contagious Diseases Activity.
- Examine technical submissions from biological and pharmaceutical firms for all veterinary biologics and other products of a veterinary nature marketed under legislation.
- Construct the necessary laboratories and ancillary structures.

With a headquarters in Ottawa, the work is carried out in laboratories located at Sackville, Grosse Île, Ste. Anne de Bellevue, Ottawa, Guelph, Winnipeg, Saskatoon, Lethbridge and Vancouver.

Key Factors (1978-79):

- Manpower costs represent \$8.5 million or 58% of the total cost of the activity.
- Laboratory materials and supplies amount to \$1.9 million and represents 11% of the total cost of the activity.
- Man-years authorized are principally for scientific research (46), veterinary science (33), scientific support (168) and general operational personnel (97).

Performance indicators:

Fifty per cent of resources for the Animal Pathology activity are allocated to Diagnostic Services. These services support several disease control and eradication programs such as Brucellosis and Tuberculosis, as well as support the Meat Inspection activity through the provision of confirmatory diagnosis of blood and tissue samples.

The following table shows the number of various types of diagnostic tests carried out in the Animal Pathology Laboratories across the country. The testing techniques, depending upon the test conducted, all vary considerably in complexity and units of labor required to perform them. They generally reflect an increased workload and efficiency due to the use of modern technology associated with the diagnostic processes.

<u>Types of Diagnostic Tests</u>					
	<u>1973-74</u>	<u>1974-75</u>	<u>1975-76</u>	<u>1976-77</u>	<u>1977-78</u>
Brucellosis:					
- Blood tests	1,490,008	1,841,541	2,150,400	2,379,834	2,689,955

- Milk ring tests	311,377	305,431	267,658	266,856	235,515
- Complement-fixation	31,071	33,751	38,582	34,682	73,201
Leptospirosis	32,842	43,371	45,997	52,130	23,543
Johne's disease	8,080	7,157	9,218	6,613	6,829
Rabies	9,136	9,300	9,392	8,406	9,125
Equine infectious anemia	49,044	58,397	77,475	95,493	95,948
Bovine leubasis	6,562	--	8,715	4,610	3,424
Meat and meat products	64,902	55,134	37,594	27,224	35,935
Misc. tests	83,461	76,485	82,030	52,995	52,426
Bluetongue	--	--	--	61,314	65,205
Salmonella typhimurium	--	217	--	--	--
Mycoplasma gallisepticum	--	70	--	--	--
Total number of tests	2,086,483	2,430,854	2,727,061	2,990,157	3,291,106
Man-Years	188	188	204	220	220

Total Cost and Manpower by Responsibility Centre							
	<u>Total Cost</u>				<u>Man-Years</u>		
	<u>Estimated 1978-79</u> (\$000)	<u>Forecast 1977-78</u> (\$000)	<u>Change from 1977-78</u> (%)	<u>Actual 1976-77</u> (\$000)	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Actual 1976-77</u>
Headquarters	896	601	49	581	20	21	16
<u>Laboratories</u>							
Sackville	657	540	22	489	17	17	17
Ste. Anne de Bellevue	339	189	79	169	10	9	8

Grosse Île	253	214	18	548	7	7	7
St. Hyacinthe							
- Major capital project	50	--	--	--	--	--	--
Ottawa	6,817	6,541	4	5,652	226	224	222
Guelph	614	671	(8)	532	22	21	23
Winnipeg	228	177	29	151	8	9	7
Saskatoon	785	507	55	481	14	13	14
Lethbridge							
- Operating cost	1,898	1,600	19	1,477	55	54	53
- Major capital project	<u>1,600</u>	<u>400</u>	<u>300</u>	--	--	--	--
Total Lethbridge	3,498	2,000	75	1,477	55	54	53
Vancouver	<u>373</u>	<u>351</u>	<u>6</u>	<u>320</u>	<u>12</u>	<u>12</u>	<u>11</u>
Total Cost of Activity	<u>14,510</u>	<u>11,791</u>	<u>23</u>	<u>10,400</u>	<u>391</u>	<u>387</u>	<u>378</u>

Explanations of Major Changes:

Man-Years: The increase of 4 man-years is attributable to additional tests associated with the new livestock importation regulations of the United States on Canadian cattle.

<u>Total Cost and Manpower by Sub-Activity</u>					
<u>Sub-Activities</u>	<u>Man-Years</u>	<u>Expenditures</u>			
		<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Increase (Decrease)</u>	<u>Actual 1976-77</u>
		(thousands of dollars)			
Diagnostic Services	219	7,263	5,831	1,432	4,916

Veterinary Research	148	5,072	4,262	810	3,727
Animal Pathology Management and Administrative Services	10	448	341	107	351
Production of Biological Products	10	307	283	24	257
Advisory Services	<u>4</u>	<u>113</u>	<u>120</u>	<u>(7)</u>	<u>96</u>
Total Activity	391	13,203	10,837	2,366	9,347
Add: Services and accommodation provided without charge	—	<u>1,307</u>	<u>954</u>	<u>353</u>	<u>1,053</u>
Total Cost of Activity	<u>391</u>	<u>14,510</u>	<u>11,791</u>	<u>2,719</u>	<u>10,400</u>

Explanations of Major Changes:

Costs: The increase of \$2,719,000 in total costs is due to

(1) Six per cent increase in personnel costs	\$ 857,000
(2) Construction of the laboratory at Lethbridge	1,200,000
(3) Other operating expenses and services provided without charge from other departments	<u>662,000</u>
	<u>\$ 2,719,000</u>

<u>Major Capital Projects</u>					
	<u>Previously Estimated Total Cost</u>	<u>Currently Estimated Total Cost</u>	<u>Forecast Expendi- tures to March 31, 1978</u>	<u>Estimated Expendi- tures 1978-79</u>	<u>Future Years Require- ments</u>
	(thousands of dollars)				
Laboratory - Lethbridge, Alberta	7,000	7,000	400	1,600	5,000
- St. Hyacinthe, Quebec	<u>7,000</u>	<u>7,000</u>	=	<u>50</u>	<u>6,950</u>

Total	<u>14,000</u>	<u>14,000</u>	<u>400</u>	<u>1,650</u>	<u>11,950</u>
-------	---------------	---------------	------------	--------------	---------------

Future Years Requirements (\$000):

<u>Year</u>	<u>Lethbridge</u>	<u>St. Hyacinthe</u>	<u>Total</u>
- 1979-80	3,500	1,725	5,225
- 1980-81	1,500	2,850	4,350
- 1981-82	=	<u>2,375</u>	<u>2,375</u>
Total	<u>5,000</u>	<u>6,950</u>	<u>11,950</u>
Expected completion date:	March 31, 1981	March 31, 1982	

ACTIVITY: ADMINISTRATION

Narrative

The responsibilities are to:

- Develop and manage the policies and programs that will safeguard and improve livestock and ensure wholesomeness of meat food products.
- Ensure financial and management accounting needs of the Program.
- Ensure personnel, accommodation, material and other services.
- Conduct education, training and development of technical, professional and support staff.

The activity is in Ottawa and provides the general management and support services to the Activities of Meat Inspection, Animal Contagious Diseases, Animal Pathology, and Field Directorate and Support Services.

Key Factors (1978-79):

- Contributions included herein and amounting to \$1.9 million (54% of the total cost of activity) are to assist the extension of veterinary science teaching facilities at the three veterinary colleges.
- Manpower costs of \$824,000 represent 24% of the total cost of the activity.

- Education, training and development funds amount to \$686,000 and represents another 20% of the total cost of the activity.

<u>Total Cost and Manpower by Sub-Activity</u>					
<u>Sub-Activities</u>	<u>Man-Years</u>	<u>Expenditures</u>			
		<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Increase (Decrease)</u>	<u>Actual 1976-77</u>
		(thousands of dollars)			
Contributions	--	1,856	992	864	74
Training, Education and Development	8	686	555	131	439
Administrative Services	23	640	555	85	708
Executive and General Management	<u>3</u>	<u>167</u>	<u>146</u>	<u>21</u>	<u>138</u>
Total Activity	34	3,349	2,248	1,101	1,359
Add: Services and Accommodation provided without charge	--	<u>114</u>	<u>84</u>	<u>30</u>	<u>93</u>
Total Cost of Activity	<u>34</u>	<u>3,463</u>	<u>2,332</u>	<u>1,131</u>	<u>1,452</u>

Explanation of Major Changes:

The increase of \$1,131,000 is principally attributable to a contribution for the construction of veterinary science teaching facilities (\$864,000).

ACTIVITY: FIELD DIRECTORATE AND SUPPORT SERVICES

Narrative

The Field Directorate is responsible for the administration of the regional operations of the Program.

This Activity involves seven regional offices through which the field operations of the Meat Inspection and Animal Contagious Diseases Activities are directed.

Key Factor:

- Manpower costs of \$1.7 million are 76% of the total cost of the Activity

<u>Total Cost and Manpower by Responsibility Centre</u>							
	<u>Total Cost</u>				<u>Man-Years</u>		
	<u>Estimated 1978-79</u> (\$000)	<u>Forecast 1977-78</u> (\$000)	<u>Change from 1977-78</u> (%)	<u>Actual 1976-77</u> (\$000)	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Actual 1976-77</u>
Atlantic	250	230	9	247	10	10	10
Quebec	342	306	12	248	15	15	15
Ontario	675	578	17	625	31	31	39
Manitoba	238	214	11	189	11	11	11
Saskatchewan	249	222	12	225	10	10	11
Alberta	266	230	16	223	12	12	11
British Columbia	<u>205</u>	<u>191</u>	7	<u>177</u>	<u>9</u>	<u>9</u>	<u>8</u>
Total Cost of Activity	<u>2,225</u>	<u>1,971</u>	13	<u>1,934</u>	<u>98</u>	<u>98</u>	<u>105</u>

Explanation of Major Changes:

The change of \$254,000 is due to the salary increases for 1978-79 (6%) and to the operating costs (7%).

ESTIMATES, 1978-79

AGRICULTURE

B - Canadian Dairy Commission

Table of Contents

	Page
Program Narrative	00
Objective	00
Sub-objectives	00
Activities	00
Funding of the Commission	00
Highlights	00
Indicators of Activities	00
Summary by Vote	00
Total Cost of Program	00
Summary by Activity and Object of Expenditure	00
Manpower	00

ESTIMATES, 1978-79

AGRICULTURE

B - Canadian Dairy Commission

Narrative

Objective

To provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality.

Sub-Objectives

- To stabilize dairy farm income;
- To achieve a balance between demand and supply of dairy products;
- To encourage the productivity and efficiency of the dairy industry and the market for dairy products; and
- To improve the quality of milk and dairy products.

Activities

Administration - Co-ordination of the development of dairy policy; administration of activities of the Commission; and administration of Market Sharing Quotas through provincial marketing agencies.

Marketing - Offer-to-purchase Canadian first grade butter, skim milk powder and cheddar cheese at support prices for sale in the Canadian and export markets. Collection of levies from producers to be applied to export losses.

Dairy Farm Income Maintenance - To stabilize dairy farm income and modernize the dairy sector through subsidy payments on milk and cream delivered within Market Sharing Quotas and through the payment of carrying charges and contributions towards export losses.

Product and Market Research and Product Promotion - To develop new dairy products and promote the use of dairy products in Canada and abroad.

Funding of the Commission

The Commission obtains the funds it needs to finance its activities from four sources.

1. Parliamentary appropriation for the Canadian Dairy Commission to cover the expenses of the Administration and Product and Market Research and Product Promotion activities. (Vote 50)

2. Parliamentary appropriation for payments to the Agricultural Stabilization Board which in turn funds the Commission for amounts paid as subsidies to producers of milk and cream, for the carrying charges associated with the Marketing activities, and for the contribution towards export losses (this appropriation is included in Agriculture Vote - 20 Food Production and Marketing Program.

3. Loans from Canada to support the inventory of skim milk powder, butter and cheddar cheese held by the Commission.

4. Levies paid by the producers to cover losses incurred on the sale of surplus skim milk powder by the Commission.

Highlights

1. The sharp deterioration in world markets for skim milk powder which began early in 1975 continued in 1976-77 and is expected to last throughout 1977-78 and 1978-79. International competition has intensified and continues to exert downward pressure on world prices for skim milk powder. Canada effectively reversed an upward trend in milk production during 1976-77, but other major producing countries have not been so successful and the consequences of this production cycle in world milk production will continue to affect the Commission's operation during 1977-78 and into 1978-79.

2. Major new initiatives will be taken by the Commission to reduce the losses presently incurred on exports of skim milk powder. Intensified efforts will be directed to improve the export returns, now that the marketing strategy of the Commission has led to a significant increase in the volume of export sales. The other area for development is the potential of the Canadian market to absorb additional volume of skim milk powder. This will be accomplished through the Product and Market Research and Product Promotion activity.

Indicators of Activities

	<u>1978-79 Estimates</u>	<u>1977-78 Forecast</u>	<u>1976-77 Actual</u>
<u>Dairy Farm Income Maintenance Activity</u>			
Canadian requirement for industrial milk and cream	98 M cwt.	100 M cwt.	95 M cwt.
National market sharing quota	103.7 M cwt.	105.6 M cwt.	99 M cwt.
Subsidy for in-quota production	\$ 2.66/cwt.	\$ 2.66/cwt.	\$ 2.66/cwt.
Target return for industrial milk	\$12.42/cwt.	\$ 11.86/cwt.	\$ 11.45/cwt.
<u>Marketing Activity</u>			
In-quota levy paid by producer	\$ 1.00/cwt.	\$ 1.20/cwt.	\$ 1.35/cwt.

Over-quota levy paid by producer	\$ 7.50/cwt.	\$ 7.00/cwt.	\$ 8.60/cwt.
Loans by Canada to support inventory held	up to	up to	up to
	\$ 147 M	\$ 300 M	\$ 284 M
Support price:			
Skim milk powder	\$.74/lb.	\$.72/lb.	\$.68/lb.
Butter	\$ 1.27/lb	\$ 1.18/lb.	\$ 1.08/lb.
Inventory - March 31:			
Skim milk powder	56 M lbs.	38 M lbs.	194 M lb.
Butter	19 M lbs.	33 M lbs.	11 M lbs.

<u>Summary by Vote</u>						
(thousands of dollars)						
	<u>Estimates</u>			<u>Expenditures</u>		
	<u>To be voted</u> <u>1978-79</u>	<u>Voted</u> <u>1977-78</u>	<u>Change</u>	<u>Estimated</u> <u>1978-79</u>	<u>Forecast</u> <u>1977-78</u>	<u>Actual</u> <u>1976-77</u>
	\$	\$	\$	\$	\$	\$
Vote 50 - Canadian Dairy Commission - Program Expenditures	<u>2,951</u>	<u>1,700</u>	<u>1,251</u>	<u>2,951</u>	<u>5,918</u>	<u>1,849</u>

<u>Total Cost of Program</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	<u>Estimated</u> <u>1978-79</u>	<u>Forecast</u> <u>1977-78</u>	<u>Change</u>	<u>Actual</u> <u>1976-77</u>
	\$	\$	\$	\$
Amount to be voted (Vote 50)	2,951	5,918	(2,967)	1,849

Services provided without charge by other departments	100	87	13	82
	3,051	6,005	(2,954)	1,931
Cost of program provided by Agricultural Stabilization Board (Vote 20)	278,000	301,000	(23,000)	233,118
Cost of program financed by the Commission's equity	--	--	--	13,026
Cost of program to be funded from future years' appropriations	=	=	=	<u>195,200</u>
Total Cost of Program	<u>281,051</u>	<u>307,005</u>	<u>(25,954)</u>	<u>443,275</u>

<u>Summary by Activity and Object of Expenditure</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
<u>Activity</u>	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change</u>	<u>Actual 1976-77</u>
	\$	\$	%	\$
Dairy Farm Income Maintenance				
Subsidy payments	261,000	266,000	(2)	258,832
Contribution towards export losses	--	15,000	(100)	--
Carrying costs -				
Interest	9,000	11,000	(18)	20,801
Storage, freight and other costs	<u>8,000</u>	<u>9,000</u>	(11)	<u>15,029</u>
	<u>278,000</u>	<u>301,000</u>	(8)	<u>294,662</u>
Marketing				
Administration:				

Personnel	1,346	1,054	28	898
Other	<u>705</u>	<u>951</u>	(26)	<u>533</u>
	<u>2,051</u>	<u>2,005</u>	2	<u>1,431</u>
Product and Market Research and Product Promotion: Consulting services	<u>1,000</u>	<u>4,000</u>	(75)	<u>500</u>
Total Cost of Program before extraordinary item	281,051	307,005	(8)	296,593
Extraordinary item: Provision for losses on exports of current and prior years	=	=	=	<u>146,682</u>
Total Cost of Program	<u>281,051</u>	<u>307,005</u>	(8)	443,275

Explanations of Major Changes:

1. There is a reduction in subsidy payments in the Dairy Farm Income Maintenance activity due to the reduction of 2% in the Canadian requirements for industrial milk.

2. The 1977-78 forecast expenditures includes a government contribution towards export losses of \$15 million, announced as part of the year's Dairy Program.

3. Carrying costs are expected to decline by \$3,000,000 (15%) principally as a result of lower anticipated production of industrial milk.

4. Administration costs are expected to increase principally as a result of increased staff (9 man-years) and normal salary adjustments.

5. Product research is expected to cost \$1,000,000 in both 1977-78 and 1978-79. The market research and product promotion is approved on an annual basis. The forecast expenditure for 1977-78 is \$3,000,000. No funds have been allocated for 1978-79.

<u>Manpower</u>				
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>% Change</u>	<u>Actual 1976-77</u>
Man-Years authorized	59	50	18	53
Planned continuing employees as at March 31	59	50	18	50

Increase in personnel is to meet increased levels of activity in the program.

(4 administrative support 4 administrative services and 1 technical)

ESTIMATES, 1978-79

AGRICULTURE

D - Farm Credit Corporation

Table of Contents

	Page
Program Summary	00
Program Narrative	
Summary by Vote	00
Summary of Operations	00
Summary of Loan Activities	00
Organization Chart	00
Details	
Analysis of long-term receivables by annual interest rate and year of maturity	00
Analysis of Canada loans by annual interest rate and of maturity	00
Analysis of activities	00

ESTIMATES, 1978-79

AGRICULTURE

D - Farm Credit Corporation

Narrative

The Farm Credit Corporation is a Crown Agency established by the Farm Credit Act of 1959 as successor to the Canadian Farm Loan Board. Under the Farm Credit Act, it makes long-term mortgage loans to assist Canadian farmers in organizing viable farm businesses. It is also responsible for administering the Farm Syndicates Credit Act, whereby loans are made to groups or syndicates of three or more farmers for the joint purchase of machinery, buildings and installed equipment. The Corporation also acts as an agent of the Canada Department of Agriculture in administering the Land Transfer Plan of the Small Farm Development Program.

The head office of the Corporation is at Ottawa and there are branch offices located at Kelowna, B.C.; Edmonton, Alta.; Regina, Sask.; Winnipeg, Man.; Guelph, Ont.; Ste. Foy, Que.; and Moncton, N.B. The Moncton office serves the four Atlantic Provinces.

The function of the head office is to determine and enunciate general policy, to ensure uniform interpretation and application of the legislation and to exercise administrative and financial control.

The Corporation's lending operation is decentralized to the extent that branch managers have authority to approve or refuse loans. Other functions performed at the branch level include the disbursement of loan funds, the general administration of loan accounts relating to the maintenance of mortgaged security and repayments by borrowers, the servicing of supervised accounts, the recruitment and training of branch staff and the establishment of appropriate liaison with other provincial and federal agricultural agencies and institutions.

The Corporation has 226 resident credit advisers located in all the major agricultural areas in Canada. They advise applicants on the best use of available resources in the organization and on the development and operation of their farm enterprises as economic family farm units. They accept loan applications, carry out the Corporation's appraisal work and perform pest-loan supervision services as required.

Operations have produced losses due to the lack of interest margin on loans made to borrowers prior to November 1968. During that period, the rate charged to borrowers was 5% whereas the cost of money to the Corporation was as high as 6.875%. Operating profits are imminent as the interest margin realized by the Corporation improves.

<u>Summary by Vote</u>						
	<u>Estimates</u>			<u>Expenditures</u>		
	To be voted	Voted		Estimated	Forecast	Actual

	<u>1978-79</u>	<u>1977-78</u>	<u>Change</u>	<u>1978-79</u>	<u>1977-78</u>	<u>1976-77</u>
	\$	\$	\$	\$	\$	\$
Budgetary						
Vote 65 - Farm Credit Corporation - Estimated amount required for the operating loss of the Farm Credit Corporation for the fiscal year ending March 31, 1979	<u>500,000</u>	<u>6,800,000</u>	<u>(6,300,000)</u>	<u>500,000</u>	<u>900,000</u>	<u>959,000</u>
	<u>500,000</u>	<u>6,800,000</u>	<u>(6,300,000)</u>	500,000	900,000	959,000
Non-Budgetary						
Statutory - Loans for lending to farmers, for purchasing farms, and subscription to capital under the Farm Credit Act (R.S. c. F-2)				266,200,000	298,600,000	267,351,000
Statutory - Loans for lending to farm syndicates under the Farm Syndicates Credit Act (R.S. c. F-4)				<u>300,000</u>	<u>(700,000)</u>	<u>(870,000)</u>
				<u>266,500,000</u>	<u>297,900,000</u>	<u>266,481,000</u>
Total Program				<u>267,000,000</u>	<u>298,800,000</u>	<u>267,440,000</u>

Loans to farmers under the Farm Credit Act bear an interest rate from the date of approval equal to the base rate plus one per cent. The base rate is determined using the average yield on Government of Canada bonds payable in Canadian currency and due to mature in five to ten years. However, if a new loan under the Farm Credit Act is made, a portion of which is to be used to repay an existing Farm Credit Act loan, the current lending rate and the rate on the existing loan are blended and a composite rate is charged. The lending rate is established for

six-month periods commencing April 1st and October 1st each year and applied to all loans approved in the related six-month period.

Interest rates on borrowings from Canada by the Corporation are established for six-month periods commencing April 1st and October 1st each year in accordance with the terms and conditions approved by the Governor in Council.

New loans are historically for the purposes of acquiring additional land (38.7% in 1976-77), new units (32.8%), or permanent improvements (15.0%).

Loans to persons under 35 account for in excess of 73% of the number of loans made under the Farm Credit Act in 1976-77.

Performance Indicators:

	<u>1978-79 Estimates</u>	<u>1977-78 Forecast</u>	<u>1976-77 Actual</u>
Interest margin	.608%	.586%	.586%
Administration as a per cent of average loans outstanding	.745%	.761%	.785%
Loss on loans as a per cent of average loans outstanding	.023%	.017%	.003%
Loans in good standing	91.0%	91.4%	91.8%
Total loan portfolio (in millions of dollars)	\$2,880	\$2,590	\$2,238

<u>Summary of Operations (Farm Credit Act)</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	<u>Estimated 1978-79</u>	<u>Forecast 1977-78</u>	<u>Change from 1977-78</u>	<u>Actual 1976-77</u>
	\$	\$	%	\$
Interest income on loans to farmers	204,100	178,000	14.7	151,783
Less: Interest expense	<u>188,200</u>	<u>164,300</u>	14.5	<u>139,717</u>

	15,900	13,700	16.1	12,066
Other income	<u>1,900</u>	<u>2,100</u>	(9.5)	<u>1,640</u>
	<u>17,800</u>	<u>15,800</u>	12.7	<u>13,706</u>
Expense				
Salaries and employee benefits	14,700	13,500	8.9	12,452
Travel	1,500	1,400	7.1	1,248
Office accommodation	1,200	1,100	9.1	1,078
Provision for doubtful accounts	900	700	28.6	512
Other	<u>1,300</u>	<u>1,200</u>	8.3	<u>1,013</u>
	19,600	17,900	9.5	16,303
Less: Allocated to Farm Syndicates Credit Act and Small Farm Development Program operations	<u>400</u>	<u>500</u>	(20.0)	<u>733</u>
	<u>19,200</u>	<u>17,400</u>	10.3	<u>15,570</u>
Operating loss	(1,400)	(1,600)	(12.5)	(1,864)
Provided by Vote	<u>500</u>	<u>900</u>	(44.4)	<u>959</u>
Net loss	<u>(900)</u>	<u>(700)</u>	28.6	<u>(905)</u>

<u>Summary of Loan Activities</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	Estimated <u>1978-79</u>	Forecast <u>1977-78</u>	Change from <u>1977-78</u>	Actual <u>1976-77</u>
	\$	\$	%	\$
Loans disbursed:				

To farmers	480,000	521,000	(7.9)	443,079
To farm syndicates	2,900	2,600	11.5	1,821
For Small Farm Development	<u>300</u>	<u>300</u>	--	<u>795</u>
	483,200	523,900	(7.8)	445,695
Refinancing existing loans	<u>(125,300)</u>	<u>(136,600)</u>	(8.3)	<u>(92,231)</u>
New loans	<u>357,900</u>	<u>387,300</u>	(7.6)	<u>353,464</u>
Funds for new loans:				
Non-budgetary - Statutory	266,500	297,900	(10.5)	266,481
Repayment of principal on outstanding loans	<u>91,400</u>	<u>89,400</u>	2.2	<u>86,983</u>
	<u>357,900</u>	<u>387,300</u>	(7.6)	<u>353,464</u>

(Chart not available, see annual Report)

Analysis of Long-term Receivables

As at March 31, 1977

A summary of the long-term receivables in the aggregate, by annual interest rate and fiscal year of maturity, is as follows:

Maturities by fiscal year (thousands of dollars)							
Annual interest rate %	<u>Total</u> \$	<u>1978</u> \$	<u>1979</u> \$	<u>1980</u> \$	<u>1981</u> \$	<u>1982</u> \$	1983 through <u>2007</u> \$
5-5 7/8	371,295	30,980	18,991	19,503	20,015	20,417	261,389
6-6 7/8	362,161	24,072	11,265	11,551	11,928	12,392	290,953
7-7 7/8	542,332	31,016	12,668	13,533	14,423	15,315	455,377
8-8 7/8	698,463	41,023	13,895	14,791	15,492	16,149	597,113

9-9 7/8	270,821	12,673	3,870	4,206	4,570	4,944	240,558
10	<u>43,085</u>	<u>1,048</u>	<u>650</u>	<u>693</u>	<u>692</u>	<u>724</u>	<u>39,278</u>
	<u>2,288,157</u>	<u>140,812</u>	<u>61,339</u>	<u>64,277</u>	<u>67,120</u>	<u>69,941</u>	<u>1,884,668</u>

At March 31, 1977, accrued interest of \$87,033,000 (\$72,372,000 - 1976) and arrears of \$15,541,000 (\$10,366,000-1976) are included and are shown as maturing in the year ending March 31, 1978.

Prepayments of principal from borrowers of \$33.7 million (\$36.1 million - 1976) were received during the year and applied as a reduction of principal. As a result, this amount has reduced the principal which would have normally become due in future years.

Analysis of Canada Loans

As at March 31, 1977

A summary of the Canada loans in the aggregate, by annual interest rate and fiscal year of maturity, is as follows:

Maturities by fiscal year (thousands of dollars)							
Annual interest rate %	<u>Total</u> \$	<u>1978</u> \$	<u>1979</u> \$	<u>1980</u> \$	<u>1981</u> \$	<u>1982</u> \$	1983 through 1998 \$
3-4 7/8	18,147	2,698	2,260	2,353	2,451	2,552	5,833
5-5 7/8	303,188	35,387	28,709	29,767	31,063	32,761	145,501
6-6 7/8	654,680	46,857	38,094	40,544	43,152	45,929	440,104
7-7 7/8	551,699	28,471	19,969	21,367	22,550	23,426	435,916
8-8 7/8	530,613	29,019	12,293	13,304	14,401	15,592	446,004
9	<u>145,550</u>	<u>4,428</u>	<u>3,196</u>	<u>3,456</u>	<u>3,555</u>	<u>3,680</u>	<u>127,235</u>
	2,203,877	146,860	104,521	110,791	117,172	123,940	1,600,593

The amounts outstanding as of March 31, 1977, include accrued interest totalling \$51,694,000 (\$43,111,000 - 1976) and are shown as maturing in the year ending March 31, 1978.

<u>Analysis of Corporate Activities</u>				
(thousands of dollars)				
	<u>Expenditures</u>			
	<u>Estimates 1978-79</u>	<u>Forecast 1977-78</u>	Change	<u>Actual 1976-77</u>
<u>FARM CREDIT ACT</u>				
Number of loans approved	5,900	7,100	(1,200)	4,465
Amount of loans approved	\$ 480,000,000	\$ 550,000,000	\$ (70,000,000)	\$ 301,433,000
Average amount approved	\$ 81,400	\$ 77,500	\$ 3,900	\$ 67,510
Amount of loans disbursed	\$ 480,000,000	\$ 521,000,000	\$ (41,000,000)	\$ 443,078,600
Number of loans outstanding	72,800	72,100	700	71,419
Principal outstanding	\$ 2,747,000,000	\$ 2,478,000,000	\$ 269,000,000	\$ 2,187,436,300
Loans in good standing	91.0%	91.5%	(.5%)	91.9%
Interest margin	.609%	.587%	.022%	.587%
Administration cost as a per cent of the average principal outstanding	.735%	.746%	(.011%)	.758%
<u>FARM SYNDICATES CREDIT ACT</u>				
Number of loans approved	130	100	30	67
Amount of loans	\$ 3,000,000	\$ 2,100,000	\$ 900,000	\$ 1,336,000

approved				
Average amount approved	\$ 23,200	\$ 21,100	\$ 2,100	\$ 19,940
Amount of loans disbursed	\$ 2,900,000	\$ 2,600,000	\$ 300,000	\$ 1,821,500
Number of loans outstanding	870	890	(20)	952
Principal outstanding	\$ 10,700,000	\$ 10,400,000	\$ 300,000	\$ 11,377,000
Loans in good standing	92.0%	91.0%	1.0%	90.2%
Interest margin	.350%	.380%	(.030%)	.476%
Administration cost as a per cent of the average principal outstanding	.560%	.580%	(.020%)	.614%
<u>SMALL FARM DEVELOPMENT</u>				
Number of loans approved	15	15	--	32
Amount of loans approved	\$ 300,000	\$ 300,000	--	\$ 568,600
Average amount approved	\$ 20,000	\$ 20,000	--	\$ 17,770
Amount of loans disbursed	\$ 300,000	\$ 300,000	--	\$ 795,200
Number of loans outstanding	560	580	(20)	606
Principal outstanding	\$ 9,200,000	\$ 9,700,000	\$ (500,000)	\$ 10,016,000
Loans in good standing	87.5%	88.0%	(.5%)	88.4%
Interest margin	.610%	.650%	(.040%)	.756%
Administration cost as a per cent of the	3.50%	4.80%	(1.30%)	6.81%

average principal outstanding				
----------------------------------	--	--	--	--

1978 Report of the Auditor General of Canada – Appendix E

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX E</H1>

</CENTER>

<HR>

REPORTS OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

TO THE HOUSE OF COMMONS:

FEBRUARY 27, 1978

(The Atomic Energy of Canada Limits Report)

APRIL 11, 1978

(The Crown Corporation Report)

JUNE 29, 1978

**(on selected portions of the 1976
and 1977 Reports of the Auditor General)**

REPORT OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS TO THE HOUSE OF COMMONS, FEBRUARY 27, 1978

REPORT TO THE HOUSE

Monday, February 27, 1978

The Standing Committee on Public accounts has the honour to present its

FIRST REPORT

(The Atomic Energy of Canada Limited Report)

1. In accordance with the Standing Committee's permanent reference contained in the House of Commons' Standing Orders, your Committee has considered the Report of the Auditor General of Canada to the House of Commons for the fiscal year ended March 31, 1976, and in particular, the following items concerning Atomic Energy of Canada Limited (AECL):

Audit Operations

Paragraph 18.1 - Atomic Energy of Canada Limited--Payments to agents inadequately documented.

Financial Management and Control Study

Appendix D - Atomic Energy of Canada Limited		
Section	Contents	Paragraph Number
I	SUMMARY OF CONCLUSIONS	5-6
II	SUMMARY OF RECOMMENDATIONS	7-8
III	ANALYSIS OF TESTIMONY	9
	Background	10-16
	Payment to Agents-Argentina	17-25
	Payment to Agents--Korea	26-46
	Financial Management and Control	47-50
IV	CONCLUSIONS AND RECOMMENDATIONS	51-54
	Objectives of AECL	55-57

	The Decision-Making Process	58-63
	Business Ethics	64-69
	Renegotiation of the Eisenberg Contract	70-72
	Post-Contract Services Agreement	73-76
	Approval of Payments	77-79
	Financial Control Practices	80-82

2. The Honourable Alastair Gillespie, Minister of Energy, Mines and Resources, appeared before the Committee on December 9, 14 and 21, 1976, and the Honourable Donald MacDonald, then Minister of Finance, appeared on February 3, 1977. Their co-operation in appearing is acknowledged along with that of the following witnesses whose titles are shown as of the date of their first appearance:

Mr. J. Lorne Gray, former President, Atomic Energy of Canada Limited.

From Atomic Energy of Canada Limited:

Mr. R. Campbell, Chairman, Board of Directors;

Mr. J.S. Foster, President;

Mr. H. W. Macdonell, Director, and Chairman of the Board of Directors' Steering Committee on Management Reorganization;

Mr. J. Hardwick, Vice-President, Finance;

Mr. A.H.M. Laidlaw, Secretary;

Mr. E. Deslauriers, Treasurer.

From the Treasury Board:

Mr. S. Mensforth, Deputy Secretary, Financial Administration Branch.

From the Law Branch, House of Commons:

Mr. J.P.J. Maingot, Parliamentary Counsel and Law Clerk.

From the Auditor General's Office:

Mr. J.J. Macdonell, Auditor General of Canada;

Mr. R. Chatelain, Deputy Auditor General;

Mr. W. A. Bradshaw, Assistant Auditor General;

Mr. D. L. Meyers, Director General, Financial Management and Control Study;

Mr. P. G. Boomgaardt, Former Director General, Corporate Audits;

Mr. J. P. Boisclair, Former Deputy Director General, Financial Management and Control Study.

3. Your Committee desires to express its appreciation to the several news media organizations and individuals who undertook extensive investigation assignments, especially in foreign countries. Their work assisted your Committee in calling witnesses for further cross-examination and in securing additional evidence from witnesses who were reluctant to be frank with your Committee.

4. Your Committee sought to determine:

(a) whether the payments of agents' fees to obtain sales of nuclear power stations were for illegal or corrupt purposes;

(b) whether AECL demonstrated good judgement in its arrangements with agents engaged to obtain foreign sales orders;

(c) whether the board of Directors and management acted responsibly in directing and controlling the affairs of AECL; and

(d) whether the Government fulfilled its ultimate responsibility in giving proper attention to reviewing the objectives and administration of AECL.

I - SUMMARY OF CONCLUSIONS

5. Your Committee concludes that:

(a) some witnesses from AECL management were reluctant and unco-operative in testifying, and in the case of the chief witness, Mr. J. Lorne Gray, evasive as well;

(b) Mr. Gray, then President of AECL, on his own initiative, committed the Crown corporation, and therefore the Government and people of Canada, to immense expenditures, of public funds for agents' fees. Furthermore, Mr. Gray did not know what services were being performed by the agents nor who ultimately received the payments. In the case of the Argentine sale, he stated that he did not even want to know the agent's identity;

(c) your Committee was unable to obtain satisfactory answers to some basic questions. The successful concealment, by complex and sophisticated payment and banking procedures in foreign countries, of the identities of the ultimate recipients of the funds and the nature of services rendered, leads your Committee to suspect that some of the payments were indeed used for illegal or corrupt purposes; and

(d) Mr. Ross Campbell was brought from the diplomatic service and appointed Chairman of the board of AECL with the responsibility of renegotiating the sales contracts. He not only failed to put the

agency agreement on a better footing, but also appointed Eisenberg as exclusive agent for the sale of a second unit to South Korea without specifying the charges to be made for these services.

6. Your Committee further concludes that:

(a) the evolution of AECL from a research organization to a substantial commercial enterprise has not been subjected to appropriate scrutiny by the Government and Parliament;

(b) the decision-making process vested too much power in the former President, Mr. J. Lorne Gray, and did not provide adequate safeguards to protect the public interest and its investment in AECL;

(c) AECL management did not follow acceptable business practices in the manner in which it made arrangements for the use of agents, nor did it have due regard for the high standard of business ethics which Crown corporations should observe;

(d) the payment of large unaccountable fees by the AECL management is totally unacceptable;

(e) the Board of Directors of AECL, in the Korean sale, failed to take into account the financial and other implications of the post-contract services agreement with the agent, Mr. Eisenberg, and as a result, did not fully protect the interests of AECL;

(f) the senior management of AECL, including the Secretary, the Treasurer, and the Internal Auditor, did not properly discharge their responsibilities as officers. In particular, the limits of authority were not respected; the reporting to the Board of Directors was inadequate; and the contracts submitted for examination were not properly scrutinized. Proper Minutes were not kept. In the approval of agents' fees, an unwarranted interest payment of \$132,289 was made to the agent, Mr. Eisenberg;

(g) the Board and management of AECL did not take the necessary action to prepare the Crown corporation for its enormous commercial undertakings both at home and abroad by developing a required expertise in marketing, project control and finance; and

(h) AECL was permitted to move into highly competitive and financially risky activities without proper evaluation of its objectives, the adequacy of its financial systems, and the ability of its management to cope with the new demands involved.

II - SUMMARY OF RECOMMENDATIONS

7. Your Committee's recommendations, as detailed in Section IV, call for action by all who direct or control Crown corporations:

(a) Parliament should ensure that definitions of corporate objectives contained in legislation make parliamentary review mandatory before a Crown corporation may significantly alter the nature of its activities.

(b) The Government should ensure that:

(i) responsibilities and duties of Crown corporation boards of directors be clearly enunciated;

(ii) senior management be qualified for the tasks assigned;

(iii) its approval be required for contracts that may expose Canada to significant financial risks;

(iv) a code of business ethics be established including guidance on such matters as the use of agents; and

(v) a central government agency be designated to monitor financial practices.

(c) *The Boards of Directors* of Crown corporations should ensure that:

(i) the job requirements for senior management be better defined;

(ii) limits be established on the authority delegated to corporate officers;

(iii) standards be established defining the quality and nature of information management submits to them; (iv) the duties of senior financial officers and others involved in the contractual or payment processes be clearly defined;

(iv) decisions be based on adequate information and be properly recorded in the Minutes of Board meetings; and

(vi) contracting procedures and codes of business ethics be specified in greater detail than in the guidelines issued by the Government on December 16, 1976.

8. Implementation of these recommendations would reduce the likelihood that AECL or any other Crown corporation might lose financial control or become involved in practices that the people of Canada would not condone. In addition, AECL should:

(a) ascertain whether amounts paid to the agent for the South Korean sale were commensurate with services rendered and whether an agent should be retained for future sales;

(b) establish standards of acceptable evidence of services and expenses to support payments;

(c) monitor services rendered by the agent;

(d) eliminate any contractual uncertainties;

(e) suspend further payments until all of these matters are remedied; and

(f) refrain from making further major financial commitments until satisfactory financial practices have been implemented.

III - ANALYSIS OF TESTIMONY

9. Your Committee devoted 17 meetings to matters concerning Atomic Energy of Canada Limited (AECL) raised by the Auditor General of Canada in his 1976 Report to the House of Commons. These meetings, which started on November 30, 1976, and ended on November 22, 1977, considered matters relating to payments AECL made to agents in connection with sales of nuclear power stations to Argentina and Korea. In the light of losses AECL incurred on the Argentine contract and the Auditor General's criticisms of its financial practices, your Committee reviewed the financial management and

control of AECL. Your Committee believes that enough emerged from the hearings to obtain a general understanding of the events, to draw conclusions, and to form recommendations.

Background

10. Once almost exclusively a nuclear research agency, in the last ten years AECL was transformed into a multi-faceted organization operating in a commercial sphere. Despite the complexity of the transformed organization and the dramatic increase in the financial risks, management systems were not modified to keep pace with the new demands placed on them.

11. The development of atomic energy in Canada started during the Second World War under the auspices of the National Research Council. By the early 1950s the Government concluded that the magnitude of research activities and the potential uses of nuclear energy warranted the establishment of a separate organization. Accordingly, AECL was incorporated in 1952 as a Crown corporation responsible for nuclear energy research and its application for peaceful purposes, with emphasis on nuclear power systems to meet Canadian needs, and on improved applications of radioisotopes and radiation.

12. From its inception, AECL earned an enviable reputation for technical achievement. It became a leader in applying nuclear technology to medical uses, such as developing equipment to use irradiated cobalt for the treatment of cancer and developing a wide variety of radioactive isotopes for diagnostic purposes. Similarly, it developed industrial equipment for sterilizing medical instruments and supplies; and it marketed its products to hospitals and manufacturers all over the world.

13. At the same time AECL developed nuclear energy's potential to generate electric power. AECL's technology, known as CANDU, an abbreviation for Canadian Deuterium Uranium, uses natural uranium as fuel and heavy water (deuterium) as a control medium. AECL also became a major producer of heavy water.

14. AECL worked closely with electric utilities in Ontario and in other provinces, gaining acceptance in Canada for the CANDU technology. However, the Government and AECL were concerned because the technology had not won acceptance in the international market. AECL felt that it urgently needed a foreign sale to demonstrate international acceptance of the technology and economics of the system. Moreover, foreign sales were expected to develop a healthy high-technology industry in Canada.

15. Against this background, AECL attempted to sell its CANDU nuclear reactor in foreign markets, starting as early as 1968. Mr. Gray, AECL president from 1958 to 1974, outlined the early international marketing attempts to your Committee. He noted that giant enterprises like Westinghouse, competing against AECL, employed agents to assist them in negotiating foreign sales contracts. Your Committee also noted that the previous Canadian General Electric sale to India, which involved Canadian foreign aid as well as private financing, did not employ or use agents.

16. Although CANDU reactors had been built abroad earlier, with AECL involved in a consulting capacity, it was not until 1972 that AECL obtained its first commercial order to deliver a fully operational CANDU electric power generating station. This order came from an agency of the Government of Argentina and was formally signed on December 20, 1973.

Payments to Agents Argentina

17. In competing for the Argentine order for a nuclear power station, AECL entered into a joint venture with Italmimpianti-Societa Italiana Impianti p.a. (Italmimpianti), an Italian construction company, which became responsible for the conventional part of the nuclear power generating station. It was agreed in 1972 by Mr. Gray that Italmimpianti would take the commercial lead in selling the reactor. Mr. Lucien Sicouri, the Managing Director of Italmimpianti, refused to appear before your Committee and evaded all attempts to answer questions. Mr. Gray told your Committee that Mr. Sicouri indicated that a commercial agent would be necessary and that AECL would have to pay one-half of the agent's fees, with AECL's share limited to \$2.5 million (U.S.). Based on his inquiries about international business, Mr. Gray concluded that agents were necessary and that the overall fee for the Argentine sale, amounting to less than 2 per cent of the sales price was not unusual. Accordingly, Mr. Gray accepted Mr. Sicouri's judgment that a commercial agent was necessary and that the remuneration was appropriate.

18. Mr. Gray also agreed that AECL would not be advised of the identity of the agent and of the services to be rendered. Mr. Sicouri's proposal for an agent and Mr. Gray's consent were given orally only, and were not referred to in the Joint Venture Agreement between Italmimpianti and AECL dated August 2, 1974, and the predecessor Consortium Agreement of October 10, 1972.

19. Mr. Gray made the decision to accept an agent. Neither Government guidelines nor Company regulations dealt with the hiring of sales agents. Mr. Gray testified that he had discussed the matter with a Cabinet Committee and with the Board of Directors, and that he had received no specific direction.

20. After AECL and Italmimpianti signed the agreement to supply a nuclear power generating station to Argentina, Mr. Sicouri wrote to Mr. Gray on January 28, 1974, saying that AECL's share of the payment, \$2.5 million (U.S.), should be transferred to a nominee bank account in Switzerland in the name of the Intercontinental General Trading Establishment. Your Committee notes that Swiss banking laws make it impossible for your Committee to determine the identity of the ultimate recipients of AECL's money. Mr. Sicouri enclosed a draft letter to be used as a covering letter for the payment requested. Two weeks later, Mr. Gray replied that the AECL Board of Directors required confirmation that Italmimpianti had made a payment of the same amount for the same purpose. Mr. Sicouri wrote on March 11, 1974, that Italmimpianti had paid \$300,000 (U.S.) and that it would pay a total of \$2.5 million (U.S.). Although the letter did not confirm that Italmimpianti had paid its share, Mr. Gray wrote a letter, modeled on the draft supplied by Mr. Sicouri, to Intercontinental General Trading Establishment, c/o Banca della Svizzera Italiana, Switzerland, committing AECL to pay \$2.5 million (U.S.) within 20 days after the Argentine contract came into force and AECL received its down-payment. The letter said that the money was to be handled in the manner detailed in a letter from Italmimpianti dated November 3, 1972. The contents of Mr. Sicouri's letter of November 1972 to the bank have not been disclosed and apparently only Italmimpianti is familiar with the instructions for the disposition of the funds.

21. Mr. Gray testified that he had discussed the whole matter with the Board of Directors, but the Minutes do not mention the transaction nor do they contain a resolution appointing an agent and authorizing payment of the \$2.5 million (U.S.). If Mr. Gray's testimony is correct, the Minutes were not adequately recorded by the Corporate Secretary.

22. On April 19, 1974, AECL issued a cheque for \$2,414,500. the Canadian equivalent of \$2.5 million (U.S.), and funds were sent by telegram from the Royal Bank, Ottawa, to Banca della Svizzera Italiana, Lugano, Switzerland in Establishment. Without a written contract, without evidence that services had been received, without an invoice, and without verification that Italmimpianti had made their complete payment, AECL nevertheless issued a cheque for \$2.5 million (U.S.) to a company of

which it knew nothing but the name. The Corporate Secretary, Treasurer and Internal Auditor apparently were all aware of the transaction, but did not see fit to question the President about the substance or manner of this payment.

23. The Auditor General did not report the payment to the House of Commons until his report for the year ended March 31, 1976, because he had not detected the transaction earlier. When he raised the matter, AECL officials made their first efforts to determine the identity of the agent and how the funds were used. In an effort to get more information. Mr. Foster, then President. Mr. Campbell, the new Chairman, and Mr. Gray, former President of AECL, met with Mr. Sicouri in Montreal on November 6, 1976.

24. Mr. Sicouri declined to divulge any information. In a letter dated December 17, 1976, responding to Mr. Cambell's request for as much detail as possible, Mr. Sicouri found the request for information . . . rather unexpected", noting that since 1972 the President of AECL stated your desire to ignore the identity and the specific functions of the agent . . Mr. Gray testified that Mr. Sicouri had insisted on AECL not knowing and that AECL had acquiesced.

25. Your Committee sent numerous letters to potential sources of information, but obtained nothing authoritative about the identity of the alleged agent or about the function the agent performed.

Payments to Agents-Korea

26. The next CANDU reactor sale abroad was to South Korea. According to Mr. Gray, the sales efforts in this connection essentially started in 1968 when Mr. Shoul N. Eisenberg, President of United Development Incorporated (*UDI*) (*In the balance of this report the names UDI and Eisenberg are used interchangeable to refer to the agent employed for South Korea*), approached Mr. Gray and said that he thought that he could sell a nuclear reactor to South Korea. Mr. Gray agreed that Mr. Eisenberg should go ahead. In late 1972 Mr. Gray wrote to Mr. Eisenberg saying he was recommending to the Government that Mr. Eisenberg be appointed AECL's exclusive agent for the sale of a nuclear reactor to the Korean Electric Company.

27. Mr. Gray testified before your Committee that, although the Minutes of the Board of Directors were silent on the matter, he had indeed discussed the matter with the Board before the appointment. The Minutes of the Board meetings first refer to Mr. Eisenberg on February 27, 1973. When Mr. Public Accounts Committee Report to the House of Commons, February 27, 1978 Gray informed the Board that Mr. Eisenberg had been appointed exclusive agent for the Korean sale. No details concerning fees were contained in the Minutes.

28. Mr. Gray testified that in 1973 he discussed with a Cabinet committee the matter of engaging agents to assist in off-shore sales and took the absence of dissent as approval. Although not corroborated by extracts of Minutes of the AECL Board of Directors' meetings, Mr. Gray said that on December 13, 1974, the Board gave approval in principle to a 5 per cent agent's fee.

29. No terms and conditions were established when AECL appointed Mr. Eisenberg as exclusive agent. Mr. Gray testified that the amount of Mr. Eisenberg's fee would be determined between them before AECL entered into an agreement with the South Koreans. Mr. Gray also said that he did not assume at the time that AECL would be paying \$20 million. Other witnesses indicated that there was no uniform fee for agents, but that the amount usually ranged from less than 1 per cent to more than 10 per cent of the sales price. Mr. Gray alleged that, for international sales of power-plant

equipment, a flat fee ranging from 4 per cent to 9 per cent was customary and that fees were generally paid in a Lump sum out of the proceeds of the down-payment.

30. Your Committee noted that in the Argentine case the total fee approximated 2 per cent of the sales price and that in the Korean sale, it amounted to approximately 5 per cent. Although Mr. Gray reported that AECL's partern, Italimpianti, had performed some of the same types of services in Argentina as did the agent in Korea, no satisfactory explanation was received for the differences in the amounts.

31. On December 30, 1974, AECL signed a letter of intent with the Korean Electric Company to supply a power station. On the same day-his last as President of AECL-Mr. Gray wrote two letters to Mr. Eisenberg. The first, to a Panama address, confirmed that a \$17 million fee would be payable on the sale of a reactor to Korea. The second, to a Korean address, said 92 that \$3 million would be payable for services to be rendered after the sale at a rate of \$500,000 per year for six years.

32. By January 26, 1976, Mr. John Foster had been installed as President of AECL and Mr. Ross Campbell appointed to the new position of Chairman of the Board. On that date, a year after the date of signing, the Korean supply contract became effective, under the same date, UDI sent AECL a \$17 million invoice for completing the sale, to be paid in London, England. UDI also sent a \$500,000 invoice for the first of the six annual instalments for the post-contract services, to be paid in Hong Kong.

33. Although he had known of the agency arrangement for about a year, Mr. Foster hesitated to make the payment. Your Committee noted that this was shortly after the news of the international Lockheed scandal. Mr. Foster consulted the Chairman, Mr. Campbell, and they discussed it with government officials and with the Directors. On March 1, 1976, the Board of Directors met and sanctioned an attempt at renegotiations with the agent on the basis of AECL paying: a) legitimate, properly documented agents, costs for past services, including costs involving financing arrangements; b) a reasonable percentage fee; and c) properly documented costs for future services, which could exceed \$3 million, preferably supported by a formal agreement. The Board's mandate in the renegotiation was to obtain a proper accounting for the agents' fees and expenses. In specifying "legitimate, properly documented costs" for past and future services, the Board gave clear direction as to the kind of supporting evidence it expected the agent to provide for his services. Although Mr. Campbell gave possible savings as one of the criteria in the renegotiation, this was not reflected in the extracts of AECL Board Minutes.

34. Mr. Campbell and the Corporate Secretary, Mr. Laidlaw, met Mr. Eisenberg in Tel Aviv on March 2 and 3, 1976. During the visit a Memorandum of Understanding was prepared, essentially covering the points mandated by the Board, but in addition, it made specific provision for Mr. Eisenberg to be retained as exclusive agent for the sale of a second unit to South Korea.

35. Mr. Campbell testified that the Memorandum of Understanding simply confirmed Mr. Eisenberg as agent for the sale of a second unit to South Korea. However, the original engagement letter appointed Mr. Eisenberg exclusive agent. .. in... South Korea to act on AECL's behalf to effect a sale to South Korea of a 600 MW CANDU..." (emphasis supplied).

36. Specifically, the Memorandum of Understanding provided for:

(a) a 1 per cent commission for effecting the sale;

(b) an undetermined amount for expenses and overhead; and

(c) a 1 per cent maximum fee for costs of post-contract services which were to be properly documented and billed on a quarterly basis. A \$2 million advance would be paid for such future services.

On his return, Mr. Campbell briefly reviewed the Memorandum of Understanding with the Minister of Energy, Mines and Resources. It was approved by the AECL Board, at its March 31, 1976, meeting, and confirmed on April 7, 1976.

37. On April 7, 1976, AECL received invoices from United Development Incorporated as follows:

(a) \$5,142,392 for the 1 per cent commission;

(b) \$8,098,500 for reimbursement of expenses. This was supported by an invoice for \$5,400,000 for expenses by Mr. Eisenberg's organization incurred from June 1972 through January 1976, accompanied by a statement from UDI's auditors saying that expenses had been allocated on the basis of instructions issued by UDI's President. It was also accompanied by three invoices, already paid by UDI, from consulting firms associated with Eisenberg; Triangular Trading Co., Panama, \$1,285,000; Industrie Export GmbH, Germany, \$514,000; and International Shipping and Shipbuilding Establishment, Hong Kong, \$899,500. Each consultant payment was supported by copies of service contracts and evidence that UDI had made the payment; and

(c) \$2,000,000 for an advance on the post-contract services agreement which is subject to a maximum of \$5,142,392.

38. On April 7, 1976, the date of the invoices, Mr. Campbell concluded that the documentation was appropriate, approved the invoices and directed that the accounts be paid.

39. Although not required by the Memorandum of Understanding, which superseded previous agreements, the AECL Treasurer, Mr. E. Deslauriers, with the concurrence of Mr. Campbell, computed interest on the April 7 invoices for the period from February 26 (*one month following the effective date of the Korean contract*) to April 7. The interest of \$132,289, and the UDI invoices totalled \$15,373,181. A cheque for this amount was issued by AECL on April 7, 1976, payable to UDI's bank account in London, England.

40. The Memorandum of Understanding provided for a post-contract agreement for services to be rendered by Mr. Eisenberg until the power station warranties expired. This agreement, dated April 7, 1976, provided that all services and costs would be detailed and billed on a quarterly basis. One half of the \$2,000,000 advance payment was to be applied to the initial billings, after which AECL was required to pay billings as rendered until the maximum of \$5,142,392 had been paid. There was a further provision, that if AECL questioned any billing, it was obliged to pay UDI a minimum of \$ 175,000 for that quarter.

41. AECL received only one quarterly billing - dated April 30, 1976, for \$295,000 - which UDI applied against the advance payment. It was questioned by the Auditor General and by AECL. No steps have yet been taken by AECL to resolve this matter beyond asking UDI for further details. AECL has not defined standards of acceptable documentation. Similarly, AECL has yet to establish procedures for monitoring the services performed by UDI.

42. A number of questions remain unanswered about the apparent saving of approximately \$1.5 million which arose because AECL's obligation to Eisenberg was reduced from \$20 million to \$18.5 million. How did Mr. Campbell know what AECL was saving when the Memorandum of Understanding provided for an undetermined amount of expenses and overhead? Why did Mr. Eisenberg limit his expenses to \$5.4 million when he claims his actual expenses were much higher? Why did Mr. Gray testify that his conscience would not have allowed him to keep the savings and that he would have given a credit note to the client, the Korean Electric Company? What authority did Mr. Campbell have to appoint Mr. Eisenberg as exclusive agent for any future sales? What was to be the fee payable for any future sales?

43. The Auditor General reviewed the ,373,181 payment to UDI and concluded that the documentation available did not constitute proof, that expenses claimed by UDI had been incurred for services rendered for the benefit of AECL.

44. The Auditor General held a number of meeting with AECL's management to discuss the matter further and it was drawn to the attention of the Audit Committee of the Board. AECL attempted to obtain adequate documentation. Since the matter could not be resolved to the Auditor General's satisfaction, he reported the findings in his 1976 Report to Parliament.

45. Although Mr. Eisenberg agreed in principle to let the Auditor General review his books, the latter was not prepared to undertake such an examination without the provision that he could report his findings to Parliament, if Parliament insisted upon him doing so. Mr. Eisenberg was not prepared to accept the Auditor General's terms, insisting that and matters not strictly related to the item under investigation, would have to remain confidential.

46. Your Committee invited Mr. Eisenberg to appear as a witness with his records. He refused.

Financial Management and Control

47. In his 1976 Report, the Auditor General commented on the financial management and control practices of AECL. At the request of your Committee, the Auditor General tabled his detailed report on AECL, which outlined numerous problems and recommendations.

48. When AECL became involved in substantial commercial activities, its financial practices did not keep pace. Lacking adequate staff and expertise, the company seriously misjudged the risks it was taking. AECL no doubt suffered from the impact of inflation, but the magnitude of the losses clearly indicated fundamental weaknesses in its procedures.

49. The sale of a reactor to Argentina illustrates a number of shortcomings. AECL did not make a comprehensive study to select the partner best suited to its first attempt to deliver a fully operational nuclear power station to a foreign customer on commercial terms. It considered no other firm, but chose Italmimpianti because they had worked together on a sales effort in Italy and because Italmimpianti already operated in Argentina. AECL largely delegated its role in commercial negotiations to Italmimpianti because, in Mr. Gray's words, AECL people were babes in the woods. It is abundantly clear that AECL underestimated the cost of delivering the goods and services. For example, the price of heavy water in the December 1973 contract was set at \$63 per kilogram. The price was revised to \$140 per kilogram during the 1976 contract renegotiations and production costs were estimated at \$235 per kilogram in March 1977. In setting the sales price for the station to be delivered, AECL accepted a limit of 23.85 per cent for inflation on the prices for the Canadian goods and services for the period from

May 1972 to the completion of the station, scheduled for 1980. That this was seriously inadequate became evident in 1975, shortly after the contract came into effect. The procedures for periodic cost estimates by AECL were demonstrably inadequate. Reports of anticipated losses on the contract varied as follows:

(a) a range of \$103 to \$117 million reported in late 1975;

(b) a range of \$23 to \$38 million, reported in February 1977, following an increase in the sales price after renegotiation; and

(c) a loss of \$130 million reported in the March 31, 1977 financial statements.

The increase in the loss, following approval of the renegotiated contract, was due to under-estimation of inflation, engineering time required, and contingencies. It is apparent that AECL did not have a reasonable standard of control procedures.

50. At the direction of the Government, AECL engaged a firm of consultants to assist in improving its financial practices. The Board of Directors formed a steering committee to evaluate and approve proposed remedial actions and to monitor the progress of implementing revised systems and procedures. The chairman of AECL's steering committee reported to your Committee in May 1977 and again in November 1977 on progress achieved. He noted that much remained to be done and stressed that, in changing control procedures in a fundamental way, the major benefits would not be apparent until systems were implemented in their entirety. The Auditor General concurred with the steps being taken by AECL to improve its financial practices.

IV - CONCLUSIONS AND RECOMMENDATIONS

51. In the opinion of your Committee, some witnesses, particularly Mr. J. Lorne Gray, failed to answer questions fully and did not display a co-operative attitude. The failure to table all the relevant documentation related to agents' payments, in a logical and chronological sequence, made your Committee's task more difficult. Some witnesses did not volunteer relevant information and answered questions in the narrowest of contexts. For example, in Mr. Gray's testimony concerning his consulting earnings from Finmeccanica, an Italian company closely related to "Italmobiliare", he testified in January 1977 that he might have earned between \$5,000 and \$ 10,000. On November 15, 1977, following recent newspaper stories, he indicated that \$25,000 had been paid to his account in Europe. Only after intensive questioning by Committee Members did he indicate that a further \$25,000 had been paid to him. All of these amounts were paid during 1976.

52. The inability of your Committee to obtain answers to some basic questions leads it to suspect that some of the payments made by AECL were indeed used for illegal or corrupt purposes.

53. In assessing the testimony, your Committee faced the question 'How was any of this allowed to happen?' It is your Committee's view that:

(a) the Government and its central agencies should have more closely monitored the expansion of AECL into complex commercial activities;

(b) the AECL Board of Directors should have more effectively challenged management proposals; and

(c) the AECL senior executive officers, before entering into substantial commercial transactions, should have developed the required expertise in marketing, project control, and finance.

54. The conclusions and recommendations of your Committee are outlined under the following headings:

Objectives of AECL.

The Decision-Making Process.

Business Ethics.

Renegotiation of the Eisenberg Contract.

Post-Contract Services Agreement.

Approval of Payments.

Financial Control Practices.

Objectives of AECL

55. AECL's performance raises the question of whether it should be in the business of selling nuclear power plants abroad. Formed by the Government of Canada two decades ago to develop peaceful uses of nuclear energy in Canada, AECL has become involved internationally in the construction of nuclear power plants. There may be fundamental conflicts between the objectives of an effective research organization and of a successful commercial enterprise. Your Committee questions the process by which AECL was allowed to expand its objectives to include those of a commercial enterprise without reference to, or change in, statutory or regulatory authority.

56. Your Committee concludes that the evolution of AECL from a research organization to a substantial commercial enterprise has not been subjected to appropriate scrutiny by the Government and, until now, by Parliament.

57. Your Committee recommends that:

(a) a fundamental appraisal of the objectives of AECL be conducted by the Government. The appraisal should consider whether it is in the public interest that the Government, through AECL, should be involved in a substantial way in marketing nuclear power plants abroad. AECL's involvement in the production of heavy water should also be reviewed as part of the appraisal process; and

(b) the objectives, when clarified, be clearly conveyed to AECL's Board of Directors, management, and to Parliament.

The Decision-Making Process

58. It became clear from his testimony that Mr. J. Lorne Gray made many decisions without formal approval of the Board of Directors. The limits of his authority were not clearly established. Mr. Gray reported to your Committee that he made a number of crucial decisions after informal meetings with ministers and officials of central government agencies. The Board's task was made difficult when they were told that the Minister responsible, or the central agencies involved, had previously consented

to a proposal. Given these circumstances, it is not surprising that an active chairman would make many of the decisions himself.

59. In recent years, provincial and federal legislation has clarified the legal responsibilities of directors. Furthermore, in specific cases in the private sector, shareholders have stipulated what is expected from directors. Your Committee believes that the Government should similarly specify what it expects from directors of Crown corporations.

60. Your Committee also expresses concern that the inadequacy of the AECL Board of Directors. It is evident that the composition of the AECL Board did not adequately reflect its needs during the period when the matters under review occurred. The objectives and needs of a Crown corporation should be carefully considered when making appointments to its Boards of Directors.

61. Your Committee notes with approval the new appointees to the AECL Board in November 1976, whose experience may be more relevant to the problems of the Corporation.

62. Your Committee concludes that the decision-making process vested too much power in the former President of AECL, Mr. J. Lorne Gray, and did not provide the safeguards necessary to ensure that the interests of the people of Canada were adequately protected.

63. Your Committee recommends that:

(a) the Government establish criteria for matters which, although approved by the Boards of Directors of Crown corporations, also require Government approval through the Minister to whom they are accountable. For example, major contracts involving Crown corporations, which may expose the people of Canada to significant financial risk, should be subject to Government approval;

(b) the responsibilities and duties of the Boards of Directors of Crown corporations be clearly enunciated. As in the private sector, directors hold positions of public trust and must be held to account for the manner in which they discharge their responsibilities;

(c) Boards of Directors of Crown corporations establish limits on the authority they delegate to corporate offices. Expenditures above certain limits should require Board approval;

(d) Boards of Directors of Crown corporations develop standards defining the quality and nature of information to be submitted to them by management. Such standards should apply to proposals for planned actions as well as to accounting for actions taken. Boards should specify the kind of information they require to make their judgments, and should not simply accept what management gives them; and

(e) Minutes of meetings of Boards of Directors of Crown corporations record all matters discussed and all conclusions reached. Board approval of resolutions passed should be recorded. The responsibility for complete and accurate Minutes rests initially with the recording secretary, but is shared by all directors when Minutes are later approved.

Business Ethics

64. Irrespective of the desirability of AECL's presence on the international market, the question remains as to a proper code of business ethics to be expected of Crown corporations. AECL

engaged agents to obtain foreign orders for CANDU nuclear power stations. Relying entirely on Mr. Sicouri's instruction and judgment, Mr. J. Lorne Gray, without prior

consultation with his Board of Directors, consented to pay \$2.5 million (U.S.) to an agent for the Argentine sale, without knowing the identity of the agent or the services to be rendered. It was Mr. J. Lorne Gray who engaged Mr. Shoul N. Eisenberg for the South Korean sale because the latter offered his services; his remuneration was not fixed for two years. However, the role the agents actually played in obtaining the orders is not clear.

65. The evidence presented to your Committee failed to establish whether or not fees paid were appropriate in the circumstances. It is not known precisely what services were provided in pursuing the Argentine sale. Much was made of the world-wide scope of the Eisenberg organization, but little was reported on what Mr. Eisenberg did to earn his fee for the Korean sale.

66. AECL did not produce any evidence to show that the business ethics of the transactions were thoroughly reviewed. In responding to a question as to whether there were any indications of payments to agents being used for corrupt purposes, Mr. Foster testified "No, but there is always that suspicion." Your Committee agrees.

67. By directing that the Eisenberg agency agreement be renegotiated, the Board indicated that they did not approve of large unaccountable fees.

68. Your Committee concludes that:

(a) AECL management did not follow acceptable practices in the manner in which it determined the need for agents; engaged the agents; fixed remuneration; and monitored the services performed. In pursuing its efforts to sell CANDU reactors abroad, AECL disregarded the scrupulous manner in which Crown corporations must behave. Allegations that AECL payments may have been used for corrupt purposes were not proved by the testimony, but the suspicions remain. In making agent arrangements, AECL did not take the prudent steps required to ensure that the monies it paid would be used for legitimate purposes; and

(b) the behaviour of Crown corporations must be above suspicion. Your Committee agrees that it is unacceptable for Crown corporations to pay large unaccountable sales commissions.

69. Your Committee recommends that:

(a) Boards of Directors of Crown corporations establish appropriate contracting procedures and policies for management to follow. Deviations from the established contracting procedures should require specific Board approval. The possibility of management committing Crown corporations to open-ended arrangements with third parties, involving indeterminate sums of money, should be eliminated; and

(b) Boards of Directors of Crown corporations establish codes of business ethics, including direction on the use of agents, within the guidelines established by the Government. Agents engaged by a Crown corporation should be Public Accounts Committee Report to the House of Commons, February 27, 1978 made aware of the corporation's standard of business ethics and agree to abide by it in pursuing the company's interests.

Renegotiation of the Eisenberg Contract

70. Your Committee is uncertain as to what the Board intended to accomplish in directing that the Eisenberg agency agreement be renegotiated. Mr. Campbell testified that the objective was to establish a better precedent for future agency arrangements by obtaining a lower unaccountable fee and by establishing more of the cost on a properly accountable basis.

71. Your Committee concludes that:

(a) Mr. Campbell's renegotiation the Eisenberg agreement failed to put the agency agreement on a better footing. AECL did not receive an accounting of legitimate, properly documented agent's costs as directed by the Board. AECL did not know what services were rendered by the agent and his consultants on AECL's behalf; and

(b) AECL was not previously committed to retain the Eisenberg organization as agent for more than one sale to South Korea. As part of the renegotiations, Eisenberg was appointed exclusive agent for the sale of a second unit to South Korea. The cost of this concession may eventually prove to be greater than the \$1.5 million reduction in the Eisenberg fees.

72. Your Committee recommends that:

(a) the Government and Boards of Directors define the job requirements of senior management of Crown corporations. The persons appointed should possess the qualifications necessary for the job. The activities of AECL, as they have now evolved, demand that the organization should be under the direction of a person with proven business skills:

(b) AECL ascertain whether fees paid by Eisenberg to associated consulting firms and reimbursed by AECL, were commensurate with the services rendered. It should also determine whether other expenses charged by Eisenberg are appropriate. Provisions permitting an audit of the cost records, where costs are incurred on behalf of a public entity, are standard features in the government contracts and should be adopted by AECL; and

(c) the AECL Board of Directors review whether the Eisenberg organization is needed by AECL should a second unit be sold to Korea. In the event that it deems an agent to be essential, the Board should define, in contractual terms, the agent's services and the basis of remuneration.

Post-Contract Services Agreement

73. The renegotiated Eisenberg agreement changed the terms for services to be rendered by the agent after the signing of the South Korean sale. The original contract required AECL to pay \$3,000,000 over six years in unaccountable fees. Currently AECL is obliged to pay up to \$5,142,392 based on quarterly billings, detailing services and costs.

74. Contract terms governing quarterly billings are vague and contrary to the spirit of the renegotiation which was to achieve a full accounting of services rendered and expenses billed. Notwithstanding disputes on items billed, AECL is obliged to pay \$175,000 per quarter. No mechanism is provided to resolve disputes. Furthermore, the contract contains no provision permitting AECL to conduct an audit of expenses allocated to it by the Eisenberg group.

75. Your Committee concludes that the post-contract services agreement fell short of reasonable contract standards and did not protect the interests of AECL; and that AECL paid inadequate attention to the implications of the contractual terms.

76. Your Committee recommends that:

(a) the AECL Board of Directors establish procedures ensuring the review and approval of all contracts before signing by appropriate legal, financial, and operating officers. This should be done to ensure that the corporation is not exposed to undue risk; that it has sufficient recourse to protect its interest; that the financial impact of the agreement is clear; and that the terms of the agreement are practical and workable;

(b) the AECL Board of Directors establish standards for acceptable evidence of services rendered and expenses incurred, arising from the post-contract services agreement;

(c) AECL develop procedures to monitor the services rendered by Mr. Eisenberg. Such procedures would provide a basis for matching services billed to services received. This is particularly important because AECL has not yet received a satisfactory accounting for the first quarterly billing of \$295,000;

(d) AECL seek to eliminate contractual uncertainties, including those related to quarterly billings; and

(e) AECL suspend further payments to Mr. Eisenberg until these matters are satisfactorily resolved.

Approval of Payments

77. The manner in which cheques were issued to the agents points out serious deficiencies in AECL procedures despite the Public Accounts Committee Report to the House of Commons, February 27, 1978 fact that the Treasurer and the Internal Auditor reviewed and approved the \$2,414,500 for the Argentine sale and the \$15,373,181 for the Korean sale. In the Argentine case, they did so exclusively on the direction of Mr. Gray, without a contract obliging AECL to pay or a Board resolution to do so. They did not know who the ultimate beneficiary was or what services were rendered. The payment for the Korean sale was made on the same day that the invoices and supporting documents were submitted. Given the nature and quantity of information and the magnitude of payment, it is difficult for your Committee to believe that the Treasurer and Internal Auditor subjected the payment to the comprehensive scrutiny and study that it deserved. In effect, the payment was issued on the instructions of the Chairman of the Board.

78. Your Committee concludes that:

(a) the responsibilities of the Treasurer and Internal Auditor were not properly discharged; and

(b) AECL should not have made an interest payment of \$132,289 to UDI, since it had no obligation to do so. The original contract terms were superseded by the renegotiated agreement, and revised obligations were paid on the date invoices were rendered. If management felt obliged to pay interest, it should have sought specific Board approval.

79. Your Committee recommends that the responsibilities of senior financial officers and others approving payments within Crown corporations be clearly defined. They are obliged to exercise judgement, and accordingly, should not be unduly influenced by their superiors and accept without question the judgement of others concerning the expenditure of public funds. No one person should be in a position of expending public funds without the questioning scrutiny of others.

Financial Control Practices

80. Many AECL financial practices identified during your Committee's review of the payments to agents were found to be seriously deficient. Your Committee concurs with the recommendations of the Auditor General in his study of AECL's financial management and control, and notes that a plan for corrective action is now being implemented.

81. Your Committee concludes that:

(a) the Board of Directors and management of AECL did not take the required action to prepare the organization for the enormous commercial activities which it has undertaken. The impression left with your Committee was that AECL took unacceptable business risks due to confidence that further public funds would be available to the company in the event of difficulty; and

(b) when assigned to work with AECL in renegotiating the Argentine supply contract, central government agencies did not react to the obviously inadequate control practices or have a clear perspective of the magnitude of the problems that were the subject of the renegotiation.

82. Your Committee recommends that:

(a) AECL refrain from making further major financial commitments until it implements satisfactory financial practices;

(b) formal Government approval be obtained in advance for projects where risks exceed those which can reasonably be assumed by the Crown corporation; and

(c) the Government designate a central government agency to monitor the financial practices of Crown corporations.

83. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 2, 3, 4, 5, 6, 6a, 7, 8, 9, 10, 11, 12, 13, 14, 15, 18, 20, 23, 25, 27, 28, 29, 30, 32, 33, 38 and 39 of the Second Session and Issues Nos. 1, 3, 4, 5, 17, 20 and 21 of the Third Session*) is tabled.

Respectfully submitted,

RON HUNTINGTON

Chairman

REPORT OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

TO THE HOUSE OF COMMONS, APRIL 11, 1978

REPORT TO THE HOUSE

Tuesday, April 11, 1978

The Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

(The Crown Corporations Report)

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Reports of the Auditor General of Canada to the House of Commons for the fiscal years ended March 31, 1976, and March 31, 1977, and in particular, the following items from the Financial Management and Control Study:

(a) 1976 Report Part 5 and Appendix C - Financial Management and Control Practices of Crown Corporations; and Appendix D Reports to Crown Corporations; and

(b) 1977 Report Part 9 - Review of Actions on Reported Deficiencies in Financial Management and Control Practices of Crown Corporations.

SECTION	CONTENTS	PARAGRAPH NUMBER
I	INTRODUCTION	3-11
II	SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS	12-15
III	ANALYSIS OF TESTIMONY; CONCLUSIONS AND RECOMMENDATIONS	16-22
	A. Creation of Government Controlled Corporations	23-38
	B. Classification	39-50
	C. Financing Methods	51-61
	D. Presentation of Financial Plans to Parliament	62-77
	E. Financial Reporting	78-92
	F. Financial Management Practices of Crown	93-102

	Corporations	
	G. Responsibility of Central Agencies of the Government	103-116
	H. Audit	117-126

2. The Honourable Robert Andras, President of the Treasury Board, appeared before your Committee on April 26, 1977. His operation in appearing is acknowledged along with that of the following witnesses, whose titles are shown as of the date of their first appearance:

From the Auditor General's Office:

Mr. J.J. Macdonell, Auditor General of Canada; Mr. R. Chatelain, Deputy Auditor General;

Mr. W. A. Bradshaw, Assistant Auditor General;

Mr. N. G. Ross, Special Adviser to the Auditor General;

Mr. R. Dubois, Director General, Special Audits and Enquiries;

Mr. D. L. Meyers, Director General, Financial Management and Control Study;

Mr. P. D. M. Ward, Director General, Audit Operations;

Mr. H. E. Hayes, Director General, Audit Operations;

Mr. J. B. McKnight, Director General, Corporate Audits;

Mr. L. K. Osland, Director General, Audit Operations;

Mr. D. C. Traxel, Former Deputy Director General, Financial Management and Control Study;

Mr. J. P. Boisclair, Deputy Director General, Financial Management and Control Study;

Mr. W. E. Dickson, Principal, Audit Operations;

Mr. R. G. Carbonneau, Study Team Leader, Financial Management and Control Study of National Arts Centre Corporation.

From the Treasury Board:

Mr. J. M. Leclair, Secretary;

Mr. 5. Mensforth, Deputy Secretary, Financial Administration Branch;

Mr. B. A. MacDonald, Deputy Secretary, Program Branch;

Mr. T. E. Reid, Deputy Secretary, Efficiency Evaluation Branch;

Mr. L. McGimpsey, Director, Financial Policy Evaluation Division, Financial Administration Branch:

Mr. H. J. Mulligan, Director, Transportation, Communications and Science Division, Program Branch;

Mr. R. Salmon, Group Chief, Financial Policy Evaluation Division, Financial Administration Branch.

From the National Arts Centre Corporation:

Mr. G. H. Southam, Director General;

Mr. B. Corder, Deputy Director General;

Mr. J. Coulombe, Assistant Director General.

From the National Capital Commission:

Mr. P. Juneau, Chairman;

Mr. J. Charron, General Manager;

Mr. D.J. Morley, Director of Finance;

Mr. J. R. Hill, Director of Properties.

From the St. Lawrence Seaway Authority:

Mr. P. Normandeau, President.

From the Export Development Corporation:

Mr. J. A. MacDonald, Chairman of the Board and President;

Mr. J. R. Hegan, Vice-President, Finance;

Mr. R. H. Sumner, Vice-President, Operations, Europe and Americas.

From the Canadian Dairy Commission:

Mr. G. Choquette, Chairman;

Mr. H. R. Armstrong, Director of Finance.

From the Privy Council Office:

Mr. D. Gracey, Government Organization Division.

From Eldorado Nuclear Limited:

Mr. N. M. Ediger, President;

Mr. C. G. Baschenis, Executive Vice-President;

Mr. T. Gorman, Vice-President, Finance.

I - INTRODUCTION

3. In this document, your Committee reports on its examination of issues and comments on financial management and control of Crown corporations contained in the 1976 and 1977 Reports of the Auditor General of Canada to the House of Commons.

4. Section II provides a summary of your Committee's conclusions and recommendations which are detailed in Section III.

5. Your Committee, in considering the Auditor General's findings on accountability of and control within Crown corporations, sought to determine whether:

(a) government-controlled corporations are properly accountable to Parliament and the Government;

(b) the Government and the corporations effectively control the public funds they administer; and

(c) adoption of the Auditor General's recommendations would correct existing deficiencies.

6. In its examination, your Committee distinguished between corporations that depend on the public purse or carry on government type operations, and those that engage in commercial financially viable activities. The two reports of the Auditor General deal primarily with the former type. Most corporations called before your Committee are also of that type.

7. Your Committee devoted 13 hearings to financial management and control of Crown corporations, in addition to hearings about Atomic Energy of Canada Limited (AECL), the subject of your Committee's First Report to the House.

8. Witnesses included the Auditor General and members of his staff, a representative of the Privy Council Office, officials of the Treasury Board Secretariat, and the senior management of six corporations. The testimony provided a better understanding of financial management practices and the reasons for deficiencies. Your Committee requested the six corporations who appeared, and all other corporations examined, to report their progress in implementing recommendations of the Auditor General. All did so.

9. Although the "Government of Canada's proposals for the Direction, Control and Accountability of Crown Corporations, in future referred to as Government Proposals, were issued in August 1977, your Committee had already commenced its consideration of the state of financial management and control practices of Crown corporations as reported by the Auditor General in 1976. The Auditor General's 1977 Report assesses whether the Government Proposals would remedy the

shortcomings reported in 1976. Although the Government Proposals have not been referred to your Committee, it did ask the officials who drafted them how they satisfy the Auditor General's concerns. Your Committee, in this Report, comments on the Government Proposals only as they relate directly to findings in the Auditor General's Report.

10. The December 1977 Progress Report of the Royal Commission on Financial Management and Accountability stated that the Commission would address many of the issues considered by your Committee. Your Committee anticipates that the Commission's Final Report will provide further insight into improving control of government corporations by Parliament and Government.

11. Much could be done immediately to establish better financial management practices in corporations and to make them fully accountable to Parliament and to the Government this report your Committee identifies areas where action can be taken now, and suggests matters for the Government's consideration in developing legislative proposals to remedy deficiencies.

II - SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

12. The testimony that your Committee heard led it to conclude that:

(a) the corporate form of organization as now used makes it possible for government activities involving the spending of substantial amounts of public funds to be carried on without adequate accountability to Parliament and Government. To protect the interests of the people of Canada. Immediate action is essential to improve the way Parliament and the Government establish and set objectives for government-controlled corporations and monitor, control and receive an accounting from them; and

(b) although many practices now permitted are quite suitable for commercial financially viable corporations, government controlled corporations should receive this freedom only when they meet Parliament's criteria for being truly commercial and do not intend to seek significant government funds. Your Committee believes that all public funds demand public accountability, regardless of the form of organization through which the funds are administered.

13. Your Committee also believes that:

(a) Parliament could have much more control, as hereinafter described, in establishing and monitoring the objectives and activities of corporations without undermining in any way the responsibility and accountability of their boards of directors and management;

(b) the Financial Administration Act (FAA), which provides for the overall financial administration of the government, has not kept pace with the growth of the corporate form of government organization in that:

- it does not provide any definition of a government controlled corporation;
- it is imprecise in defining which government-controlled corporations are Crown corporations;
- it apparently does not apply to many government controlled corporations; and

- it is inflexible in providing for the orderly addition, deletion and transfer of corporations in FAA Schedules; and

(c) boards of directors and management of government controlled corporations should be required to give a high priority to financial management practices.

14. Your Committee's recommendations which apply to *all corporation controlled by the Government of Canada, (as defined in Paragraph 27 of this Report)*, call for:

(a) amending the FAA to include an appropriate definition showing the criteria which can be considered to result in a corporation being government-controlled;

(b) scheduling of all government-controlled corporations in the FAA so they may be subject to its financial provisions;

(c) establishing in Crown corporation legislation or revisions to the FAA redefined criteria for scheduling all government-controlled corporations. Such criteria should be based on:

- the degree of dependence on public funds;
- the nature of the operations; and
- the degree of government ownership;

(d) reviewing annually all government-controlled corporations by Treasury Board to determine whether changes in their objectives, activities, or degree of dependence on public funds require a change in scheduling in light of the criteria in (c) above;

(e) providing the Governor in Council with the power by public Order in Council to effect the orderly addition, deletion and transfer of all government-controlled corporations in the Schedules to the FAA; and

(f) providing Parliament with an up-to-date list of all government-controlled corporations and such additional information as a shareholder might expect to receive.

15. All other recommendations of your Committee are aimed at achieving adequate parliamentary and governmental review and control of *corporations that depend largely on government financial support or provide services not likely to be undertaken by the private sector*. These recommendations call for:

(a) use of loans and equity investments only where it is expected that they can be repaid out of earned income;

(b) providing adequate information on spending plans to Parliament and the Government on an integrated basis;

(c) improving financial reports in the Public Accounts based on Generally Accepted Accounting Principles;

(d) putting mandates for auditors that include reporting where money has been expended without due regard for economy or efficiency or where satisfactory procedures have not been

established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented;

(e) giving the Comptroller General clear responsibility for providing guidelines that set acceptable standards of financial management and control; and

(f) immediate action by the Treasury Board to remedy existing deficiencies.

III - ANALYSIS OF TESTIMONY;

CONCLUSIONS AND RECOMMENDATIONS

16. Government activities have grown substantially in size and complexity since 1951 when the FAA, which provides for the overall financial administration of the Government, became law. Government departments still administer most programs but the Government increasingly uses the corporate form to provide services to the public and to supply internal government requirements for goods and services. Part VIII of the FAA, which establishes the general financial rules that apply to the corporations listed in its Schedules, has had no significant changes since the Act's inception.

17. Section 66 of the FAA defines a Crown corporation as one "that is ultimately accountable, through a Minister, to Parliament for the conduct of its affairs, and includes the corporation named in Schedule B (Departmental), Schedule C (Agency) and Schedule D (Proprietary)". However, the Schedules to the FAA do not include many other corporations which are either wholly or partially owned by or controlled by the Government.

18. Your Committee's hearings were limited to those government-controlled corporations audited by the Auditor General and which for the most part are contained in Schedule C or D of the FAA. These are engaged in a wide range of activities which outwardly may have commercial characteristics but which often have objectives that preclude comparison to corporations in the private sector. All but one of the corporations examined depend largely on government financial support and provide services not likely to be undertaken by the private sector.

19. Although the Auditor General audits those corporations listed in Schedule B to the FAA, these were not included in his study of financial management and control of Crown corporations since they are treated for financial purposes as departments. For this reason and because they were addressed in your Committee's Sixth Report of the First Session of the Thirtieth Parliament, dated June 30, 1976, Schedule B corporations are not covered by this Report.

20. Section 70 of the FAA requires both Schedule C and D corporations to submit capital budgets which are tabled in Parliament. Only Schedule C corporations must submit operating budgets to the Government although these are not tabled in Parliament. The FAA authorizes Treasury Board, on a joint recommendation of the President of Treasury Board and the appropriate Minister, to prescribe the form of these budgets. Other provisions in the FAA dealing with financial statements, banking arrangements, annual reports and audits are the same for both Schedule C and D corporations. Recognizing the original purposes for which Parliament established Crown corporations, the FAA provides more latitude for Crown corporations than do the rules that apply to departments.

21. The corporations not listed in the Schedules of the FAA, but controlled by the Government of Canada, have not been subjected to the provisions to the FAA. It appears that they are subject only to the legislation under which they are created. Conversely it appears that one of the

corporations listed in the Schedules of the FAA is no longer deemed to be a Crown corporation, i.e., Polysar Limited.

22. In 1976 the Auditor General reported that financial management and control of Crown corporations of which he was the auditor was weak and ineffective. The following issues were raised in his Report and in your Committee's hearings:

- creation of corporations owned or controlled by the Government;
- classification of Crown corporations;
- financing methods;
- presentation of financial plans to Parliament;
- financial reporting;
- financial management practices of Crown corporations;
- responsibility of central agencies of the Government; and
- audit.

A. *Creation of Government-Controlled Corporations*

23. The Treasury Board Secretariat recently listed 384 corporations wholly or partially owned by or controlled by the Government. It is clear that the Government controls a corporation and any subsidiaries in cases where it owns all or a majority of voting shares of the corporation. However, your Committee notes that Government control over corporations may also be achieved:

- by the ability to appoint a majority of directors of corporations without share capital; or
- by being the provider of funds without which the corporation could not continue to operate; or
- by owning a minority portion of voting shares when that portion is sufficient to result in effective control.

24. Your Committee notes with concern that the FAA does not define the circumstances in which control is achieved by the Government over a corporation and believes that conventional definitions of control such as those contained in taxation statutes may be inappropriate in circumstances peculiar to government. Without a proper definition of the criteria that must be present before a corporation can be considered to be government-controlled, the confusion surrounding this issue will continue and the appropriate listing of corporations in the Schedules to the FAA will continue to be difficult.

25. The draft legislation and proposed amendments to the FAA, which form part of the Government Proposals, contain proposed definitions of government-controlled corporations. Your Committee has not attempted to evaluate these or to formulate a definition of control which would cover all situations.

26. However, your Committee noted with concern that the Government Proposals would result in two different definitions which would be contained in two Acts of Parliament. (See *Appendix "A" of the Government Proposals on page 50, Section 2(4), and page 59, Section 26.*) The proposed definitions do not include situations in which effective control is achieved through owning a minority portion of voting shares when that portion is sufficient to result in effective control. Likewise the Government Proposals do not refer to situations where the Government is the provider of funds without which the corporation could not continue to operate.

27. For the purposes of this Report, your Committee will use the combined basic characteristics of the Government's proposed definitions when referring to government-controlled corporations because these definitions include the majority of corporations in which the Canadian Government has substantial direct investments. That is:

(a) corporations in which the Government of Canada either directly or indirectly holds shares, membership interests or other evidence of interest to which are attached more than 50 per cent of the votes that may be cast to elect directors. (*This would exclude situations in which the Canadian Government holds shares, etc., by way of security only.*); and

(b) corporations without share capital, of which the directors are appointed or elected by or with the approval of the Governor in Council.

28. No comprehensive list of government-controlled corporations had been prepared until your Committee requested the Treasury Board Secretariat to do so. The list was received in May 1977 and showed 366 corporations wholly or partially owned by the Government of Canada. This list was revised and in January 1978 it included 384 corporations. Not all of these, however, are active. Your Committee noted the comment made by the Treasury Board Secretariat official that the listing of corporations in which the Government has an interest was prepared even though no mandate existed for them to do so.

29. Of the 384 corporations wholly or partially owned by or controlled by the Government, 41 are listed by the Treasury Board Secretariat as Schedule C and D corporations, and are known as Crown corporations. These have apparent majority share ownership in 73 corporations which in turn have apparent minority holdings in another 24 corporations. The diagram attached as Appendix "A" provides an interview of the structure of the Government's holdings in the corporations listed by the Treasury Board Secretariat.

30. Your Committee did not assess the impact of the Government's holdings in other than Schedule C or D Crown corporations but noted with concern testimony from Government officials that central government agencies lack control over the acquisition or establishment of subsidiaries by government-controlled corporations.

31. Your Committee was also concerned about the existing definition of a Crown corporation in the FAA. It is not clear from this definition when a corporation "is ultimately accountable, through a Minister, to Parliament for the conduct of its affairs". Although the FAA states that all corporations listed in its Schedules are Crown corporations, the Government deems one of them, Polysar Limited, not to be a Crown corporation. Governor in Council powers extend only to transferring corporations already listed, between the FAA Schedules, and no power exists to delete a corporation from the Schedules. It is not clear in the FAA whether the Governor in Council can add to the Schedules the names of even wholly-owned corporations not already listed in one of the Schedules. Further, the FAA is passive in

allowing but not requiring periodic review of the Schedules and transfers amongst them where appropriate.

32. The Auditor General recommends that all government controlled corporations be scheduled in the FAA and that they be subject to appropriate provisions in order to ensure that the controls Parliament and the Government require are clearly defined and recognized by all parties concerned.

33. The National Arts Centre Corporation (NAC) was the only corporation to appear before your Committee which is not listed in the FAA Schedules. However, it is one of the corporations that clearly depend on Government financial support.

34. The Government Proposals do not require that all government corporations be scheduled under the FAA, and they specifically exclude from scheduling any that are not wholly-owned. The Government Proposals state that Parliament is to be better informed by including the financial statements of all government-controlled corporations in Volume III of the Public Accounts. Acquisition of a controlling interest in a corporation by the Government will require an Order in Council to be made public.

35. The absence of clear knowledge of the corporations controlled by the Government underscores the need for legislation placing them under parliamentary scrutiny. Parliament will know that it is properly and fully informed on the status of all corporations the Government controls if each is scheduled under the Financial Administration Act. In its Report on Polysar Limited, your Committee also concluded that there was a need for clearly defining in legislation all agencies of the Crown, including those it substantially owns or effectively controls.

36. If all government-controlled corporations are scheduled, your Committee believes that Parliament will have the apparatus to determine the most appropriate forms of planning, scrutiny and control for each class of corporation.

37. Your Committee concludes that:

(a) Parliament receives inadequate information about the existence and objectives of corporations owned by the Government of Canada:

(b) the FAA definition of Crown corporation limits the Act's applicability and creates confusion; and

(c) present legislation does not sufficiently provide for regular review of the appropriateness of scheduling, additions and deletions from the Schedules, and the orderly transfer of corporations amongst the Schedules.

38. Your Committee recommends that:

(a) the FAA be amended to include an appropriate definition of a government-controlled corporation:

(b) Crown corporation Legislation require that FAA Schedules list all government-controlled corporations and contain provisions for appropriate financial control:

(c) the Public Accounts include annually a list of all corporations controlled by the Government of Canada and provide financial statements and the additional information a shareholder might expect to receive; and

(d) the Governor in Council have power by public Order in Council to effect the orderly addition to, deletion from, and transfer within the Schedules of the FAA, of all government-controlled corporations.

B. *Classification of Government-Controlled Corporations*

39. The FAA now specifies the following criteria for a Crown corporation to be classified under:

(a) Schedule C

"any Crown corporation that is an agent of Her Majesty in right of Canada and is responsible for the management of trading or service operations on a quasi-commercial basis, or for the management of procurement, construction or disposal activities on behalf of Her Majesty in right of Canada."

(b) Schedule D

"any Crown corporation that

(i) is responsible for the management of lending or financial operations, or for the management of commercial and industrial operations involving the production of or dealing in goods and the supplying of services to the public; and

(ii) is ordinarily required to conduct its operations without appropriations."

40. The Auditor General studied all of the 33 Schedule C and D corporations which he audits. He noted that nearly all of them, whether listed in Schedule C or D, depended largely on public funds and received over \$700 million in budgetary appropriations in 1976. These represent a small proportion of all government-controlled corporations.

41. The St. Lawrence Seaway Authority is an example of a corporation that depends largely on public funds. As a Schedule D corporation, it would ordinarily be required to operate without government appropriations, yet it has required substantial public funds over a period of years. The Seaway, moreover, is an integral part of the water transportation system in Canada, a large part of which is administered by the Ministry of Transport, a department of government to which different and more stringent forms of control and accountability apply.

42. If a corporation carries on a commercial activity, your Committee does not question the need for a form of organization which provides a degree of operational independence from government. However, your Committee is concerned that, where substantial public funds are provided to such a corporation, financial rules should take account of the source of funds that it administers.

43. The Government Proposals advocate that all criteria for classifying Crown corporations be removed from the FAA and that they be scheduled according to the degree of financial control the Government desires for each. Government officials told your Committee that financial viability should

be considered in determining the extent of government control, but that there may be other criteria as well.

44. The Canadian Broadcasting Corporation was cited as one example meeting the other criteria. Although not purely commercial in nature or financially viable, it has been classified in Schedule D to give it the operational independence needed to ensure its artistic integrity. The National Arts centre Corporation which apparently meets the same criteria, is not included in any of the Schedules of the FAA.

45. Government officials did not tell your committee how they would determine the financial control needed or provide a list showing the proposed scheduling of existing Crown corporations and government-controlled corporations not now scheduled. The Government Proposals, moreover, have not given details concerning the nature of the financial controls that would apply to each Schedule.

46. The Auditor General told your Committee that the mechanisms needed to ensure accountability and control over public funds need not infringe on the operational independence of Crown corporations.

47. The Auditor General's Report concludes that the criteria used to classify Crown corporations should not be deleted from the FAA but should be clarified and applied. One classification should be provided for financially dependent corporations or for those carrying on government-type operations. He proposed at least one other classification for government-controlled corporations that meet the test of financial viability and carry on commercial activities.

48. Your Committee believes that all government-controlled corporations that administer public funds or carry on government-type operations should submit to Parliament the information it requires to monitor their performance both prospectively and retrospectively. Proper classification for financial purposes would not interfere unduly with the operational independence they require to achieve their stated goals.

49. Your Committee concludes that:

(a) government-controlled corporation objectives and activities have not been subject to adequate periodic review by Parliament and the Government; and

(b) proper accountability is required for all expenditures of public funds regardless of the form of governmental organization chosen to achieve objectives.

50. Your Committee recommends that:

(a) Crown corporation legislation or revisions to the FAA contain redefined criteria for scheduling all government-controlled corporations:

(b) Legislation provide separate schedules for corporations:

(i) substantially dependent on public funds or carrying on government operations;

(ii) meeting the test of financial viability and carrying on commercial operations;

(iii) only partly government-owned; and

(c) all government-controlled corporations be reviewed annually by the Treasury Board to determine whether changes in their objectives, activities or dependence on public funds require a change in scheduling and for the President of the Treasury Board to make a recommendation to Parliament based on the criteria in (b) above.

C. *Financing Methods*

51. The methods used by government-controlled corporations to finance their operations have a significant effect on their financial statements and on the way advances to them are recorded in the accounts of Canada.

52. Depending on the form of financing, the corporations' statements can show the government's contribution:

- (a) as a loan subject to repayment and bearing interest;
- (b) as share capital outstanding;
- (c) as a credit to offset deficits;
- (d) as contributed surplus.

53. The Government records the first two types as investments; the last two are written off in the accounts of Canada when made.

54. Some corporations also borrow from external sources. Such loans are not recorded in the accounts of Canada, except as contingent liabilities where the Government guarantees them.

55. Your Committee heard testimony about a number of government loans which corporations could not repay. Among these were loans to the St. Lawrence Seaway Authority, National Harbours Board and the Canadian Dairy Commission. The Auditor General's Report criticized the lack of effective review of the ability to repay when a corporation requests a loan. It recommended that corporations follow procedures common in the private sector and prepare feasibility studies for use by the Government before loans are granted. The Report stated that amounts advanced to corporations should be treated as expenditures in the accounts of Canada unless repayment is likely.

56. Your Committee noted during the hearing devoted to the St. Lawrence Seaway Authority that debt amounting to \$624 million was in effect forgiven by the decision to treat it as a permanent investment, rather than an interest-bearing loan. This was done because of the Seaway's inability to repay the principal or even the interest. Because of this treatment, the amount of the asset in the accounts of Canada was not reduced, although a reduction had been recommended by the Auditor General.

57. Your Committee considered whether corporations should borrow from external sources instead of from the Consolidated Revenue Fund. The Auditor General's Report criticized this practice since it results in an understatement of the net debt of Canada and it may create commitments against the Consolidated Revenue fund without the specific approval of parliament. Crown corporations report external borrowings in capital budgets tabled in Parliament but these budgets do not require parliamentary approval.

58. The Government Proposals favour extended use of external financing because it increases flexibility in financing, curtails the cash drain on the Consolidated Revenue Fund, and exposes the commercial aspects of Crown corporations to market disciplines.

59. The draft Crown corporation legislation appended to the Government Proposals allows all Schedule C and D corporations to borrow money from external sources. Schedule C corporations require Governor in Council approval, and Schedule D corporations require Minister of Finance approval except for loans of 18 months or less. The Government Proposals call for all borrowings by Crown corporations, as agents of Her Majesty, to be listed in a separate schedule in the Public Accounts. Your Committee is concerned about the potential extra cost of such borrowings, and whether the market will look more to the Government than to the corporation for repayment. In many cases there may be an implicit, if not a legal guarantee by the Government of the obligations of corporations it controls. Although defaults on external debt have not occurred in Canada, they have been experienced by government corporations in other countries. Your Committee is concerned that Crown corporations now have, and would continue to have under the Government Proposals, the power to negotiate external loans without specific approval by Parliament.

60. Your Committee concludes that:

(a) Crown corporations have received loans where budgetary appropriations would have been more suitable;

(b) Converting unrecoverable loans to equity investments continues to overstate the assets of Canada; and

(c) external borrowing by government-controlled corporations creates potential charges against the Consolidated Revenue Fund without approval of Parliament.

61. Your Committee recommends that:

(a) corporations support requests for loans with feasibility studies, cash flow projections and other techniques commonly used in the private sector and that loans be granted only where it is expected all principal and interest will be recovered;

(b) non-recoverable loans to corporations be written off in the accounts of Canada through budgetary appropriations; and

(c) external borrowing by corporations be subject to specific parliamentary approval through the Estimates.

D. *Presentation of Financial Plans to Parliament*

62. Annual capital budgets of Crown corporations are tabled in Parliament. If a corporation requires an appropriation, the Estimates contain limited additional information. This is the only financial planning information Parliament receives. Operating budgets for Schedule C Crown corporations are prepared for the approval of the appropriate minister and the President of the Treasury Board, but these are not tabled in Parliament.

63. Under the FAA, the Treasury Board prescribes the form of the Estimates. However, in order to prescribe the form of capital and operating budgets, the Treasury Board needs a joint recommendation of the President of the Treasury Board and the appropriate minister.

64. The Auditor General criticized practices in his 1976 Report and in testimony. Major deficiencies in Crown corporation planning documents cited were:

- (a) poor and inconsistent content, form and quality;
- (b) fragmentation and incomplete portrayal of activities;
- (c) omission of continuing authorities from the Estimates;
- (d) failure to disclose the effect of proposed capital projects on operational costs;
- (e) late capital and operating budgets; and
- (f) the lack of written guidelines.

65. Your Committee's hearings on the Canadian Dairy Commission (CDC) and the St. Lawrence Seaway Authority provided examples of some of the deficiencies noted by the Auditor General.

66. Your Committee attempted to obtain a proper understanding of the financial plans of the CDC as portrayed in the Estimates. A number of sections of the Estimates contain information about CDC but activities are not grouped and budgeted for in a complete manner in one place. Some funds for CDC are requested by another Crown agency. The Chairman of the CDC testified that he too found it difficult to identify in the Estimates where CDC's funding requests were located and how big they were.

67. The CDC Chairman testified that the Commission is closely controlled by Parliament through its annual review of the dairy program. Your Committee questions this assertion in the light of the above testimony.

68. Unless the recommendations in this Report are adopted, Parliament may lose its annual opportunity to review St. Lawrence Seaway Authority Estimates because the Authority may no longer require appropriations due to a conversion of interest-bearing loans to an equity investment. Your Committee heard testimony that this financing practice has no real bearing on the Seaway's intrinsic ability to be profitable. The Corporation continues to administer assets completely paid for by public funds and continues to carry on operations of a Governmental nature.

69. Your Committee noted that little or no useful information was provided in support of a requested appropriation by the Seaway to cover a budgeted deficit of about \$59 million. The scant information excluded such basic operational data as the projected gross revenue and expenses. This would be corrected if operating budgets were integrated with the Estimates.

70. The Government proposals require that operating budgets be tabled in Parliament if substantial funds are required, and that operating and capital budgets be tabled at the same time as the Estimates where possible. They also provide for multi-year financial plans, but these will not be

tabled in Parliament. The Treasury Board will gain sole authority to specify the form and nature of information to be presented in capital and operating budgets.

71. Government officials stated that their particular concern was to introduce some order into financial planning by Crown corporations. They cited the need for legislation before acting in this area. Your Committee is concerned that wrong or conflicting decisions might result if the plans submitted continue to be fragmented or incomplete.

72. The Auditor General said that, although the Government proposals would improve the resource allocation and budgetary control process, the Estimates, operating budgets and capital budgets of Crown corporations still would not be combined to provide an integrated set of plans conveniently available in the Estimates. Without such integrated plans, it would be virtually impossible for Parliament to hold individual Crown corporations to account.

73. Testimony from government officials did not explain why the Estimates could not contain integrated financial plans; however, they were concerned that disclosure of operating budgets could place Crown corporations at a competitive disadvantage. Your Committee noted, however, that this argument does not apply to the many Crown corporations that do not compete with the private sector.

74. Your Committee believes that current FAA provisions do not provide the basis for Parliament and the Government to receive the type of information necessary to decide on resource allocation. The poor quality of information and the delays in providing it, make this unsatisfactory situation still worse.

75. Your Committee believes that the growing size and complexity of government demand that Crown corporations submit integrated financial plans to Parliament so that parliamentarians can effectively review proposed uses of public funds. Your Committee believes that to facilitate Parliament's review of plans and to establish the basis for their subsequent accountability, the various budget documents now submitted by Crown corporations should be improved in quality and consolidated to provide a complete plan of proposed activities.

76. Your Committee concludes that:

(a) the financial plans submitted by corporations requiring public funds or carrying on governmental operations do not facilitate informed decision-making or provide a proper basis for subsequent accountability;

(b) information presented to Parliament and the Government needs to be integrated and significantly improved in form and quality; and

(c) The Treasury Board has taken little initiative to improve the reporting of financial plans of Crown corporations to Parliament and the Government.

77. Your Committee recommends that:

(a) all government-controlled corporations that depend on public funds or carry on operations of a governmental nature submit comprehensive financial plans as part of the Estimates process; and

(b) the Treasury Board provide adequate guidance to eliminate the deficiencies in the Estimates.

E. *Financial Reporting*

78. Your Committee heard testimony on two aspects of financial reporting of Crown corporations: (1) the nature and format of reporting in the Public Accounts of Canada and annual reports; and (2) the accounting principles Crown corporations use in preparing financial statements.

79. Your Committee also heard that:

(a) the Canadian Dairy Commission does not report financial results on a basis consistent with that used when funds are appropriated;

(b) the National Capital Commission (NCC) tabled its Annual Report for 1976 in the House five months after the statutory filing date; and

(c) no central government agency has legislative authority to ensure that reports are tabled on a timely basis.

80. Where corporations undertake activities of a governmental nature, the Public Accounts of Canada do not reveal the relationship of these activities to similar ones carried out through the departmental form of government organization. For example, the cost of providing a system of water transportation in Canada is borne through government departments and government-controlled corporations. The total cost of providing this transportation facility is not disclosed anywhere in the Public Accounts of Canada.

81. Volume III of the Public Accounts contains the financial statements of Crown corporations, but most other government-controlled corporations do not appear there. Volume III does not summarize financial information, such as advances from public funds, presented in the individual Crown corporation financial statements.

82. Government officials told your Committee that they did not have a clear understanding of the nature and extent of information required by parliamentarians and that they would hesitate to summarize the information described in Paragraph 81 above. Accordingly, they limited their proposals to improving financial reporting by Crown corporations by publishing the statements of all government-controlled corporations in the Public Accounts.

83. The Government Proposals also provide that the content of published annual reports of Crown corporations will continue to be prescribed by the appropriate minister.

84. The Public Accounts of Canada do not lay before Parliament the financial information needed to assess activities of Crown corporations in relation to departmental activities or to understand their collective impact. Parliament and the public should not have to become experts on the Public Accounts or compile data dispersed through three volumes. The Government's accountants should have the professional competence and independence to provide meaningful summary information.

85. Your Committee heard extensive testimony on whether or not Crown corporations should adhere to Generally Accepted Accounting Principles as laid down by the Canadian Institute of Chartered Accountants. It noted that the Government requires corporations in the private sector to adhere to these Principles.

86. The Government Proposals reject a statutory requirement for adherence to the Principles. Government officials said that certain departures may be warranted and cited basic differences between Crown corporation objectives and the primary private sector objective of profitability. They testified that (1) they would wish greater disclosure by Crown corporations, including disclosure of matters not related to accounting such as the use of agents in obtaining overseas orders and Appendix E information about the organization itself; and (2) the Government Proposals would require Treasury Board to approve accounting principles for each corporation wholly owned by the Government.

87. The officials were unable to provide your Committee with examples of specific instances in which they would recommend accounting principles less stringent than those recommended by the Canadian Institute of Chartered Accountants.

88. During hearings on individual Crown corporations, such as AECL and the St. Lawrence Seaway Authority, your Committee noted that departures from the use of the Principles had resulted in reporting assets at higher levels and costs at lower levels than if assets of questionable value were written off, and yet interest on loans and depreciation were provided for as the Principles require.

89. After several hours of testimony from the Auditor General, expert accounting witnesses, and government officials, your Committee does not understand why the Government Proposals reject mandatory use of the Principles. No instances were cited where they would not be appropriate. One official suggested that this would not be appropriate. One official suggested that this would provide a "Loophole" for exceptional circumstances.

90. Your Committee acknowledges that the Government may not wish to be always bound by practices recommended by a professional organization. Nevertheless, Parliament can always legislate exemptions. The widely understood rules that apply to the private sector should not have to be relearned by those preparing, auditing and using financial information of Crown corporations, and the Government should not need to duplicate work already done.

91. Your Committee concludes that:

(a) financial reports by corporations should provide better accountability to Parliament and the Government for the use of resources provided from the public purse; and

(b) failure to apply the Generally Accepted Accounting Principles of the private sector to Crown corporations is inconsistent with the choice of the corporate form of organization and is detrimental to effective communication of financial information. The Government Proposals provide sweeping power to Treasury Board to determine how the financial position and results of operations of Crown corporations are disclosed to Parliament.

92. Your Committee recommends that:

(a) the Public Accounts of Canada be improved by:

(i) Integrating in Volume II departmental and cord rate financial data;

(ii) comparing all financial data in Volume II with the information in the Estimates; and

(iii) providing summary financial information in Volume III; and

(b) Legislation require Crown corporations by regulation to adhere to Generally Accepted Accounting Principles as recommended by the Canadian Institute of Chartered Accountants plus such other information as Treasury Board may specifically direct.

F. *Financial management Practices of Crown Corporations*

93. Your Committee questioned in detail the senior management of those Crown corporations who appeared before it, including AECL, on the adequacy of their Financial management and control practices.

94. In the bearing on Eldorado Nuclear Limited, your Committee heard testimony which indicated that its senior officers recognize the importance of proper financial management.

95. Eldorado management, with the endorsement of its Board of Directors, has adopted a code of ethics to guide management and employees in confidentiality, disclosure and administration and conflicts of interest. It is of concern to your Committee that members of the Board were exempted from signing this conflict of interest declaration.

96. Your Committee was pleased to note that an audit committee of the Eldorado Board has been formed as a further positive step towards improving its financial management and control system.

97. Major deficiencies were noted in financial management and control within the National Arts Centre Corporation, a corporation not classified as a Crown corporation. These included the failure to provide for proper controls over lease revenues, over payrolls, and over short-term investments. Also the Committee noted with concern the NAC's failure to obtain proper approval for purchase of a computer system, to establish an internal audit function, and to reduce the losses incurred on its restaurant operations. Arguments were presented by the NAC that financial management and control standards might infringe on the artistic independence of the Corporation.

98. Your Committee examined the financial practices of the National Capital Commission including the timing of its annual report, its tendering procedures for leased properties, the need for an audit committee, and its financial reporting practices. The NCC agreed with all of the recommendations made by the Auditor General's financial management and control study and reported that it had begun action to correct the deficiencies.

99. Your Committee, in considering the financial management practices of the Canadian Dairy Commission, noted with concern its failure to implement basic controls over inventories and sales orders. It also noted the previous lack of a chief financial officer with appropriate status and reporting relationships. Officials testified that they planned to have most major problems in financial management and control corrected March 31, 1978. Your Committee remains concerned about the length of time between the submissions of the Auditor General's recommendations and the Commission's proposed target implementation dates.

100. Your Committee received and attached to its Minutes of Proceedings and Evidence, copies of progress reports from other Crown corporations on implementing recommendations of the Auditor General. It was encouraging to note the positive action reported. The Auditor General testified that it was too early to judge the success of these corrective actions. Your Committee will review the Auditor General's monitoring of these efforts.

101. Although financial management and control practices vary in quality from corporation to corporation, your Committee concludes that many Crown corporation directors and management have not managed public funds entrusted to them with proper attention to sound financial management and control practices.

102. Your Committee recommends that the Auditor General follow up and report back to this Committee on the implementation of recommendations in his reports on the financial management and control of Crown corporations.

G. *Responsibilities of Central Agencies of the Government*

103. During hearings, your Committee heard evidence that the FAA does not clearly provide for a role for a central government agency in many of the areas where the Auditor General reported serious deficiencies as a result of his financial management and control study of Crown corporations.

104. Government officials cited the lack of specific legislative authority as the reason for not acting in many of these areas. They said that they rely on persuasion and diplomacy to obtain certain information.

105. Your Committee noted that Treasury Board has the legal authority to prescribe the form of the Estimates. During hearings, it became clear to your Committee that the Estimates frequently fail to provide Parliament or the Government with adequate information concerning the activities for which corporations are requesting funds. The Treasury Board has taken no significant action to remedy this deficiency.

106. The Auditor General recommended that legislation clearly define the role of a central agency in ensuring that all segments of the public purse be protected and that a proper accountability be provided for all expenditures of public funds. He recommended that a central agency provide direction and leadership by:

(a) setting standards for financial management and control practices;

(b) ensuring that the financial plans of these corporations provide complete and meaningful information to Parliament and the Government;

(c) providing comparisons of actual results to approved plans; and

(d) ensuring that the financial reporting of corporations be based on Generally Accepted Accounting Principles, consistently applied, and include appropriate supplementary information.

107. Because of the serious weaknesses in Crown corporation financial management and control, the Auditor General was of the opinion that ministers, boards of directors, and management would welcome a central agency's guidance on standards. These standards would not infringe on the responsibility of boards of directors and management, but would help them to establish essential controls.

108. The Government Proposals call for the responsibility of financial management and control to remain exclusively with boards of directors. The Government Proposals state that the Government will outline its recommended administrative systems and procedures to the Royal

Commission on Financial Management and Accountability. The content of this outline had not been finalized and therefore was not available to either your Committee or the corporations.

109. Your Committee notes that discussion on the Government Proposals is incomplete; that anticipated Legislation has not yet been prepared; and that the Royal Commission is still sitting. In addition, the Auditor General has expressed his concern that too much time will elapse before action is taken to correct the deficiencies revealed to your Committee.

110. It is the opinion of your Committee that Treasury Board officials could have done more under existing legislation to effect improvements in financial management and control of Crown corporations and in the methods used to achieve accountability to Parliament.

111. Your Committee shares the Auditor General's concern that delay is neither necessary nor acceptable and supports his suggestions that at least the following could be done now:

- (a) give Parliament comprehensive information on government-controlled corporations;
- (b) require proper feasibility studies for loans requested from the Government;
- (c) establish guidelines for Crown corporations on the form and content of capital and operating budgets;
- (d) request Crown corporations to table operating budgets at the same time as the Estimates if appropriations or loans are being sought;
- (e) encourage Crown corporations to adhere to Generally Accepted Accounting Principles; and
- (f) provide standards and preferred practices to Crown corporations on financial management practices.

112. If the above actions were taken, it would be normal to expect that the ministers responsible would ensure that Crown corporations co-operate fully with the central agency.

113. Your Committee rejects the position advanced by spokesmen for some Crown corporations that government prescribed standards for financial management and control would infringe on the independence of corporation directors and management and diminish their responsibility. Your Committee believes that public funds demand public accountability.

114. Your Committee believes that immediate action should be taken and that Treasury Board should not wait for legislation. It supports the view of the Auditor General that the Comptroller General should exercise responsibility in this area.

115. Your Committee concludes that:

- (a) no agency of government has yet been assigned responsibility for giving financial leadership and monitoring public funds entrusted to corporations; and
- (b) central agencies have not yet used effectively the authorities they have been given.

116. Your Committee recommends that:

(a) the role of the Comptroller General he clearly defined to ensure that public funds administered through the corporate form of government organization be subject to proper standards of financial management, control and accountability; and

(b) the Treasury Board Secretariat initiate action now to redress deficiencies noted in the Auditor General's Financial Management and Control Study.

H. *Audit*

117. The audit requirements for most Crown corporations are contained either in the FAA or in the legislation incorporating them. The requirements of the FAA go beyond those that generally apply in the private sector in that Section 77(1) requires the auditor to call attention to any other matter falling within the scope of his examination that in his opinion should be brought to the attention of Parliament."

118. Your Committee noted that in his 1977 Report, the Auditor General stated his intention to audit corporations that depend, in whole or in part, on public funds in the same manner and using the same mandate as for departments.

119. In testimony before your Committee, the Auditor General explained that this meant applying his mandate under Section 7(2) of the Auditor General Act which requires him to report if:

"(d) money has been expended without due regard to economy or efficiency; or

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented."

120. In arriving at this position, the Auditor General testified that both accounting and legal counsel supported this interpretation of the Auditor General Act and that he felt Parliament would not wish him to apply different standards to corporations that are governmental in nature and depend, in whole or in part, on public funds.

121. Your Committee noted that existing legislation and the Government Proposals do not specifically require this type of audit for government-controlled corporations where the appointed auditors are private firms. Your Committee also noted that the information the Auditor General may require from auditors of Crown corporations to satisfy his responsibilities as auditor of the accounts of Canada may extend to efficiency and effectiveness areas, although it would not now be his intention to pursue this broader mandate.

122. The Auditor General suggested that new legislation should clarify whether or not private auditors should broaden their scope when auditing government-controlled corporations that depend on public funds or carry on governmental operations.

123. Government officials expressed concern that private firms might be placed in some difficulty or be embarrassed if they were asked to apply the value-for-money audit concept. However, a partner of a national accounting firm testified that private firms are capable of doing such audits.

124. Your Committee believes that the standard of audit and accountability for public funds spent by corporations should not be less than that required of the Government itself. Through the recently enacted Auditor General Act, Parliament has prescribed the types of audits it expects where

public funds are involved. Similar standards should apply to many government-controlled corporations. The different standards of the private sector are adequate only if the corporation is carrying on a commercial activity and is not significantly dependent on public funds.

125. Your Committee concludes that present legislation does not clearly provide for consistent standards of audit for public funds whether administered by the corporate form of government organization or by government departments.

126. Your Committee recommends that:

(a) Crown corporation legislation prescribe the same audit standards as provided for departments, for government-controlled corporations funded from the public purse and which carry on operations of a governmental nature;

(b) the Auditor General fulfil his legislative mandate under Section 7(2)(d) and (e) of the Auditor General Act for all Crown corporations of which he is the auditor and which are partly or wholly dependent on public funds; and

(c) legislation provide the same mandate for private auditors as for the Auditor General in auditing government-controlled corporations that depend significantly on public funds or carry on operations of a governmental nature.

127. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 1, 14, 15, 16, 17, 18, 22, 24, 25, 27, 28, 29, 30, 31, 32, 33 and 38 of the Second Session and Issues Nos. 1, 6, 7, 9, 10, 11, 12, 13, 14 and 22 of the Third Session*) is tabled.

Respectfully submitted,

RON HUNTINGTON,

Chairman

(Appendix A not available, see annual Report)

REPORT OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

TO THE HOUSE OF COMMONS, JUNE 29, 1978

REPORT TO THE HOUSE

Thursday, June 29, 1978

The Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

1. In accordance with its permanent Order of Reference contained in the Standing Orders of the House of Commons, your Committee has considered the Reports of the Auditor General of Canada to the House of Commons for the fiscal years ended March 31, 1976, and March 31, 1977, and in particular, the following items:

(a) 1976 Report Appendix D and E Financial Management and Control Studies, and the 1977 Report Appendix D - Financial Management and Control Study;

(b) 1977 Report parts 3, 4, 5, and 6 - Computer and Information Systems Evaluation Study, and Paragraph 17.10 -Weaknesses in control over Unemployment Insurance benefit payments;

(c) 1977 Report Special Audits and Inquiries paragraphs 10.9, 10.10, 10.16 to 10.21 inclusive, 11.1 to 11.19 -inclusive, 12.1 to 12.18 inclusive, and 12.31 to 12.40 inclusive; and

(d) 1977 Report Valuation of Pension Accounts; and Canada Pension Plan Projected Deficiency-Paragraphs 14.9 and 17.6.

2. The cooperation of the following witnesses is acknowledged:

From the Department of the Secretary of State:

Mr. A. Fortier, Under Secretary of State;

Mr. G. T. Rayner, Senior Assistant Under Secretary of State;

Mr. R. L. Lachapelle, Director General, Education Support Branch;

Mr. P. E. Larose, Superintendent of Translation.

From the Department of Indian Affairs and Northern Development:

Mr. A. Kroeger, Deputy Minister;

Mr. R. J. Fournier, Assistant Deputy Minister, Finance and Administration;

Mr. R. J. Knox, Director General, Program Support (Indian and Eskimo Affairs Program).

From the Department of Supply and Services:

Mr. J. L. Fry, Deputy Minister of Services and Deputy Receiver General of Canada;

Mr. G. A. Berger, Assistant Deputy Minister, Commercial Supply;

Mr. D. J. Steele, Assistant Deputy Minister, Management Services, Services Administration;

Mr. B. Crossfield, Director General, Compensation Services Branch;

Mr. K. W. Reed, Director General, Payment Services Branch;

Mr. D. C. Baxter, Director General, Data Processing Branch;

Mr. A. G. Irvine, Director General, Government of Canada Accounting Branch, Services Administration;

Mr. T. Dunbar, Director, Central Accounting, Government of Canada Accounting Branch.

From the Royal Canadian Mounted Police:

Superintendent F. Fedor.

From the Department of Employment and Immigration:

Mr. J. L. Manion, Deputy Minister;

Mr. R. St. Laurent, Executive Director, Benefit Program;

Mr. F. Godbout, Executive Director, Finance and Administration.

Mr. B. K. Dertinger, Executive Director, National Systems and Services.

From the Department of National Revenue Taxation:

Mr. B. MacDonald, Deputy Minister;

Mr. H. E. Garland, Assistant Deputy Minister, Operations;

Mr. D. S. Brooks, Acting Assistant Deputy Minister, Systems and Planning.

From the Department of Finance.

Mr. D. Clark, Assistant Director, Federal-Provincial Relations Division:

Mr. R. A. McLarty, Senior Economist, Social Development and Manpower Policy Division;

Mr. L. Konomis, Chief, Special Projects, Government Finance Division.

From Statistics Canada:

Mr. P Kirkham, Chief Statistician of Canada

Mr. N. Francino, Director General, Policy, Planning and Evaluation Branch.

From the Department of Energy, Mines and Resources,

Mr. C. H. Smith, Senior Assistant Deputy Minister;

Mr. W. McKim, Assistant Deputy Minister of Administration;

Mr. H. D. Fleck, Director, Financial Services.

From the Canada Council:

Mr. Charles Lussier, Director;

Mr. T. Porteous, Associate Director;

Mr. C. Gauthier, Director of Administration and Finance.

From the National Museums of Canada:

Mr. Andre Bachand, Vice-Chairman of the Board of Trustees of the National Museums of Canada; and Chairman of the Special Committee on Finance and Audit of the Board of Trustees;

Ms. Jennifer R. McQueen, Acting Secretary General;

Mr. Richard Herring, Assistant Secretary General, Planning and Administration;

Mr. Arthur Trickey, Assistant Secretary General, Finance and Administration;

Mr. Dann Michols, Director, Museum Assistance Programme.

From the Department of National Health and Welfare.

Miss A. K. Liljefors, Director, Planning and Evaluation, Income Security Programs Branch;

Mr. D. Smith, Acting Director General, Financial Administration.

From the Department of Insurance.

Mr. W. Riese, Chief Actuary.

From the Treasury Board.

Mr. R. L. Richardson, Deputy Secretary, Program Branch;

Mr. S. Mensforth, Deputy Secretary, Financial Administration Branch;

Mr. P. Meyboom, Deputy Secretary, Administrative Policy Branch;

Mr. W. Pajor, Director, Information Systems Division, Administrative Policy Branch;

Mr. A. G. Ross, Director, Financial Policy Development, Financial Administration Branch;

Mrs. N. Gendreau, Director, Evaluation, Analysis and Data Services Division, Personnel Policy Branch;

Mr. D. D. Harris, Director, Administrative Standards Division, Administrative Policy Branch;

Mr. W. A. Kelm, Director, Pension and Benefits Division, Personnel Policy Branch;

Mr. N. H. Duncan, Group Chief, Financial Policy Research and Advisory Services Division. Financial Administration, Branch;

Mr. A. Silverman, Group Chief, Financial Policy Evaluation Division, Financial Administration Branch;

Mr. J. VanDoornick, Senior Project Officer, Administrative Standards Division, Administrative Policy Branch.

From the Auditor General's Office.

Mr. J.J. Macdonell, Auditor General of Canada;

Mr. R. Chatelain, Deputy Auditor General;

Mr. R. Dubois, Assistant Auditor General;

Mr. P.D. Lafferty, Assistant Auditor General;

Mr. H. Hayes, Director General, Audit Operations;

Mr. E. Dickson, Director General, Audit Operations;

Mr. E. Peters, Principal, Computer Audit Services;

Mr. E.F. McNamara, Principal, Study of Procedures in Cost Effectiveness;

Mr. P. D. Ward, Principal, Financial and Management Control Study;

Mr. B. Thompson, Principal, Audit Operations;

Mr. M. W. Greenwood, Director, Special Audits and Inquiries;

Mr. W. Comerford, Manager, Audit Operations;

Mr. R. J. Rosen, Adviser to the Auditor General, Computer and Information Systems;

Mr. D. Desautels, Special Adviser, Unemployment Insurance Commission Statistical Sampling Study;

Mr. L. J. Duff, Project Leader, Computer and Information Systems Evaluation Study;

Mr. R. Healey, Project Leader, Computer and Information Systems Evaluation Study;

Mr. E. Case, Study Team Leader, Financial Management and Control Study;

Mr. B. Travers, Study Team Leader, Financial Management and Control Study;

Mr. J. Callum, Member of the Computer and Information Systems Evaluation Study

3. Your Committee held 19 hearings with respect to the following review areas:

A - Financial Management and Control Study (*FMCS*) of Government Departments, Agencies and Corporations.

B - Computer and Information Systems Evaluation (*CAISE*) Study.

C - Grants and Contributions.

D - Travel and Relocation Expenses.

E - Receipt and Deposit of Public Money.

F - Use of Statistical Data in Determining Certain Government Expenditures.

G - Canada Pension Plan (*CPP*) - Projected Deficiency.

A - Financial Management and Control Study (FMCS) of Government Departments. Agencies and Corporations

4. Your Committee continued to review the financial management and control practices of certain government departments, agencies and corporations that were highlighted in the Auditor General's 1975, 1976 and 1977 Reports. In accordance with a procedure established two years ago, your Committee requested in March 1978 a progress report from 33 government departments, agencies and corporations on the implementation of the Auditor General's recommendations. These reports are appended to Issue No, 28 dated June 6, 1978, of the Committee's Minutes of Proceedings and Evidence.

5. Your Committee believes that this procedure has not only strengthened the parliamentary accountability process, but has also greatly assisted the Auditor General and the Treasury Board Secretariat in monitoring the action taken by the various governmental organizations. In cases where progress is reported to be below an acceptable level, your Committee will request those departments, agencies and corporations to account for their actions.

6. Because of certain identifiable concerns raised in the Auditor General's Report and the FMCS progress reports, your Committee heard evidence with respect to the financial management and control practices from the following:

- Department of Indian Affairs and Northern Development,
- Department of the Secretary of State,
- Canada Council, and
- National Museums of Canada.

Your Committee supports the recommendations of the Auditor General contained in the FMCS reports of these organizations and is concerned that implementation of these recommendations continues to be slow.

7. The analysis of the testimony led your Committee to the following conclusions:

(a) a senior full-time financial officer is required and should report directly to the head of the organization and should be a full-time member of the management committee in order that financial management takes its proper place in the decision-making process. A situation such as the one that exists in the Department of the Secretary of State, where the senior financial officer is only one of fifteen reporting to the Senior Assistant Deputy Minister, does not appear satisfactory to your Committee. The Canada Council, on the other hand, has a designated senior financial officer who has so many other time-consuming administrative duties that the financial management and control of that organization is weakened;

(b) stronger financial direction and leadership are required of senior financial officers in departments, agencies and corporations to ensure that the quality of financial administration throughout the organization is maintained at an acceptable level;

(c) Treasury Board as the key central agency should exercise more functional direction and leadership with departments, agencies and corporations;

(d) the authority granted by Parliament for the Indian Arts and Crafts Revolving Fund was deliberately exceeded by \$400,000 by officials in the Department of Indian Affairs and Northern Development without, in the opinion of your Committee, adequate disciplinary action being taken. Your Committee cannot condone such action;

(e) slow progress is being made in establishing a proper system of internal audit within the Department of Indian Affairs and Northern Development and the Canada Council;

(f) substantial improvements are needed in the financial control of funds managed by native organizations, particularly with respect to the accountability to Parliament of the contributions to Indian bands;

(g) because it was created under a separate Act and is independent of the Financial Administration Act, the Canada Council has no financial accountability to Parliament or to Treasury Board for the spending of public funds by means of grants and contributions; and

(h) Treasury Board officials are reluctant to take any initiative with respect to the FMCS of Crown corporations unless Treasury Board's responsibilities are clearly defined. Current legislation is deficient in this respect, as elaborated by your Committee in its Second Report to the House (*The Crown Corporations Report*), dated April 11, 1978.

8. Your Committee recommends therefore that the Auditor General monitor the action taken and to be taken in those areas by the organizations concerned.

9. Your Committee recommends that consideration be given to amending existing legislation to include the Canada Council in Schedule B of the Financial Administration Act and thereby subject it to the financial requirements of the Treasury Board and consequently to Parliament.

10. Your Committee regards the breach of the Financial Administration Act by officials who exceed spending appropriations as a serious matter and recommends that:

(a) adequate disciplinary action be taken against individuals responsible; and

(b) Treasury Board implement proper financial controls that will prevent recurrence of such breaches.

11. Your Committee recommends that statutes governing the Treasury Board be enlarged to strengthen its role to financial management and control over Crown Corporations.

B - Computer and Information Systems Evaluation (CAISE) Study

12. The Computer and Information Systems Evaluation Study by the Auditor General had the objective of reviewing and evaluating the controls pertaining to electronic data processing (EDP) resources throughout the government and its entities.

13. Your Committee held six meetings on this topic and found that there is need for:

(a) more effective management of EDP and control procedures at the departmental level;

(b) the Treasury Board Secretariat to provide directives, standards and a strengthened monitoring process in order to achieve consistency throughout government;

(c) improved security to protect equipment, programmes, and the classification of information both within the government and within the private sector contracting to the government; and

(d) more involvement of financial personnel in the development, operation, and audit of EDP financial systems.

14. Your Committee reports that the Treasury Board Secretariat and the departments basically support the Auditor General's recommendations and that steps have been taken to implement them. Both the Treasury Board Secretariat, by revising Chapter 2 of their *Guide on EDP Administration*, entitled "Management Responsibilities for EDP", and the RCMP, by developing security standards, have acted to remedy the weaknesses.

15. Nine departments were reviewed by the Auditor General's CAISE team and the following three were examined by your Committee:

- Department of Supply and Services/Services Administration,
- Department of National Revenue/Taxation, and
- Department of Employment and Immigration/Unemployment Insurance Commission.

16. Two areas of concern were noted within the Department of Supply and Services Central and Regional Pay System:

- deficiencies in the control of pay input data; and
- deficiencies in the control over processing (*output was not always reconciled with input*).

The Auditor General advised that corrective measures are being taken.

17. With respect to the Department of National Revenue- Taxation, two control weaknesses were detected in the T-1 processing stream:

- financial accounting; and
- physical security.

The Department advised that remedial measures were being implemented.

18. In the Department of Employment and Immigration Unemployment Insurance Commission, controls were found to be less than adequate with respect to:

- the ability to assess or validate the eligibility of claimants; and
- data entering the Benefit and Overpayment System.

Your Committee noted the need for balance between prompt service to claimants and the need for more controls. Your Committee considered that action taken to date by the Department will improve controls by:

(a) ensuring the involvement of financial personnel in the design and the ongoing operation of systems; and

(b) improving the preventive controls in order to validate all the data provided prior to the authorization of payments.

However, your Committee agrees with the Auditor General that follow-up studies should be undertaken to determine the most appropriate course of action as not all corrective measures have been implemented.

19. The Auditor General reported that improvements are required in management control over EDP resources and over the financial information processed by computers. The departments stated that the Auditor General's recommendations will be complied with and implemented, and your Committee notes that action has already been taken in the revised guides on EDP administration and on security standards.

20. Your Committee expects that the Treasury Board Secretariat will find the capability to monitor corrective action. Your Committee notes that the Auditor General has raised the question whether the Treasury Board Secretariat has assigned sufficient staff to this function.

21. Your Committee recommends that the Auditor General continue to report on the progress made by departments in implementing his recommendations.

C - Grants and Contributions

22. Your Committee held six meetings to examine the Auditor General's Special Study on Grants and Contributions. This two-year Study sought to evaluate the adequacy of financial management and control over grants and contributions in all departments and agencies of government for which the Auditor General has audit responsibility.

23. Grants and contributions of twenty government departments, agencies and corporations were reviewed by the Auditor General and the following three were examined by your Committee:

- Canada Council,
- Department of Energy, Mines and Resources,
- and National Museums of Canada.

24. In addition to specific concerns within certain government departments, agencies and corporations, government-wide problems were identified. Your Committee found four major areas of concern:

(a) that the previous Treasury Board Circular on Grants and Contributions was inconsistently applied, wrongly interpreted or substantially ignored. Widespread confusion between grants and contributions is evident and in some cases the terms are used interchangeably;

(b) that there appears to be insufficient effort to ensure the most efficient use of funds and a lack of adequate measures to enforce accountability by recipients. Documentation substantiating requests for grants or the detailed accounting for contributions was lacking;

(c) that there is a lack of control, monitoring, and evaluation of grants and contributions. Instances were noted of contributions exceeding the authorized amount or being increased or renewed without proper accountability on the funds previously provided. There is no central listing of grants and contributions nor are complete individual lists of recipients available in all donor departments in order to prevent duplicate funding; and

(d) that the Estimates and the Public Accounts do not now show individual grants and contributions in a form which facilitates examination and year-to-year comparisons.

25. Your Committee notes that the Treasury Board has helped considerably to clarify the area of grants and contributions through its revised Circular 1977-50. The Office of the Comptroller General is expected to monitor departmental compliance. Your Committee intends to review the Auditor General's reports on the effectiveness of the application of the revised Circular which is intended to resolve the deficiencies in paragraphs 24(a), (b) and (c) above.

26. Your Committee also notes that certain recommendations of the Auditor General have not been incorporated in the revised Circular. After careful consideration, your Committee concludes that most of the suggestions made by the Auditor General in this regard not only call for improved disclosure in the Estimates and the Public Accounts, but also strengthen the accountability process and Parliament's control of the public purse.

27. Your Committee therefore recommends to the Treasury Board that:

(a) all grants and contributions over a minimum amount be shown separately in the Public Accounts;

(b) where practical, grants and contributions be coded by category of use and by province, in both the Estimates and the Public Accounts;

(c) lists of recipients of grants and contributions be a matter of public record in each department and measures be taken to prevent duplicate funding; and

(d) financial assistance of a capital nature be classified as contributions (not grants) and administered as such, including the requirements for the submission of financial statements and reports on the use of funds.

28. Your Committee further recommends that the Auditor General closely monitor the progress made in this area.

D - Travel and Relocation Expenses

29. Your Committee examined a study by the Auditor General on travel and relocation expenses. It was directed towards assessing the extent to which departments and agencies comply with Treasury Board regulations, directives and guidelines; the effectiveness of Treasury Board and departmental controls in ensuring efficient use of funds allocated to travel and relocation; and the adequacy of disclosure given to these expenses in the Public Accounts. Over a two year period, the travel and relocation expenses of 25 departments and 8 Crown corporations were reviewed by the Auditor General. The study also included foreign travel expenses and the operations of the Central Travel Service.

30. The evidence before your Committee revealed many instances of non-compliance with Treasury Board regulations, directives and guidelines; absence of travel authorization and control; lack of regard for the economic and efficient use of travel funds; and abuse of travel advances.

31. Your Committee notes that the Treasury Board Secretariat has responded favourably to the Auditor General's recommendations in this area and has revised its travel directive. Your Committee has been assured by the Secretariat and the Auditor General that they will be monitoring compliance on a regular basis.

32. Your Committee, however, is most concerned that current legislation does not permit Treasury Board to apply its travel directives to Crown corporations. Your Committee believes that where public funds are involved, public accountability must follow and that Crown corporations should conform to such requirements,

33. Your Committee therefore recommends that consideration be given by the Government to providing the appropriate legislation that will extend Treasury Board policies to Crown corporations,

34. Your Committee noted the concerns of the Auditor General with respect to the Central Travel Service: the delay in formalizing arrangements with the two airline companies for providing reservation and ticket services; and the weak financial procedures in the central billing system. It has been subsequently reported to your Committee in a letter to the Chairman dated June 5, 1978, (Appendix "PA79") that some progress has been made in these two areas, including a Treasury Board Secretariat inter-departmental study. The Auditor General has been asked to inform the Committee of future progress.

E - Receipt and Deposit of Public Money

35. Your Committee notes the Auditor General's observations with respect to the receipt and deposit of public money in government departments which revealed:

- (a) inadequate control of cash receipts;
- (b) non-compliance with Treasury Board regulations;
- (c) delays in depositing cash receipts;
- (d) Losses caused by delay in converting cash receipts in foreign currencies;
- (e) delays in transferring receipts into interest-bearing accounts; and
- (f) weaknesses in controls over the establishment and operation of transfer accounts and deposit facilities.

36. Some departments show a lack of awareness or concern over the fact that idle money does not bear interest and that delays in processing receipts cause loss of interest revenue to the Crown. In one specific area, it has been estimated that the Receiver General by improving procedures regarding the transfer of funds to the Bank of Canada in Ottawa, through the telex deposit system, can improve interest earnings up to \$4 million annually.

37. Some departments continued to deal with unauthorized deposit facilities in spite of a legal opinion precluding their use.

38. Your Committee concludes that such deficiencies in the receipt and deposit of public money reflect the earlier observations of the Auditor General on the state of financial management and control in government departments and agencies. Furthermore, they reflect the need for adequately trained financial staff, sound internal procedures, and improved internal audit capability within the departments concerned.

39. Your Committee recognizes the progress made by the Receiver General with respect to the transfer of funds to the Bank of Canada. Moreover, a spokesman from the Treasury Board assured your Committee that they would monitor the total area of receipt and deposit of public money in the departments concerned. Your Committee supports this action.

F - Use of Statistical Data in Determining Certain Government Expenditures

40. The Auditor General observed that controls are inadequate to ensure appropriate secondary use of statistical data in determining certain government expenditures and recommended that Treasury Board undertake a study of the use of statistics by the Treasury Board Secretariat. One example of a situation that gave rise to the Auditor General's concern was the transfer of Federal funds to the provinces based on population statistics that were compiled for another purpose.

41. During testimony the Treasury Board Secretariat declined to make any policy statement or judgment as to the accuracy or the appropriateness of the data in cases where the concerned parties (*i.e., the donor and recipient of the funds*) had agreed that the data are satisfactory to them.

42. Statistics Canada stated that the responsibility for using the statistics to determine any payment is the responsibility of the programming department.

43. The Treasury Board stated that it accepts Parliament's authorization of the statistics being used but does not accept the responsibility for determining whether the statistical data are appropriate.

44. It is difficult for your Committee to comment on the Auditor General's observations concerning the possible inequity of government spending based on inappropriate secondary use of statistical data and on the implications of improving Treasury Board's monitoring ability or Statistics Canada's resources.

45. Your Committee recommends that one or more of the following steps be taken by the Government in examining this matter further:

(a) placing it as an item on the agenda at the next Federal-Provincial Conference;

(b) calling it forthwith to the attention of the Royal Commission on Financial Management and Accountability (Lambert Commission) and asking for their comments; and/or

(c) requesting Treasury Board to undertake a special study and report on the matter.

G - Canada Pension Plan (CCP) - Projected Deficiency

46. When the Canada Pension Plan was introduced in 1965, it was established as a partially funded system to be financed exclusively by employer and employee contributions. The CPP Act provides that all contributions shall be credited to the CPP Account, all pensions and supplementary benefits shall be charged to that Account, and no payment shall be made in excess of the credit balance in the Account. While contributions are collected and recorded by the Federal Government, the investment of the Fund is at the discretion of the provinces.

47. The Auditor General in his 1977 Report and in his opening remarks before your Committee, observed that the government actuary had predicted that unless the rate of contributions were increased:

- by 1983, annual benefits would exceed contributions;
- by 1990, loans to the provinces would require repayment; and
- by the year 2000, the CPP Account would be exhausted.

48. Furthermore, the Auditor General pointed out that there is no explicit provision for an automatic increase in contribution rates, and any alteration in these rates requires a three year period of exposure to Parliament before coming into force, and agreement by at least two-thirds of the ten provinces having an aggregate of not less than two-thirds of the population.

49. Your Committee recognizes the significance of the Auditor General's observations and the seriousness of the problem with respect to the next twenty years of the Plan. Your Committee notes the testimony of the Departments of Insurance and Finance with regard to their respective projections, and acknowledges their difficulty in dealing with so many unknown factors and varying assumptions. However, because of the wide range of unpredictability associated with the underlying assumptions, and because of the time factor involved, your Committee supports the view that Parliament should establish certain bench-marks for the review of this Plan at periodic intervals.

50. Your Committee accepts the proposed action by the Office of the Auditor General that an independent actuary will be consulted to verify the reports of the Department of Insurance.

51. Your Committee notes that a federal-provincial committee is now working in this area and recommends that its findings be made public.

52. Your Committee also recommends that beginning in 1979 and at specified three-year intervals thereafter a Committee of the House of Commons make an examination of the Canada Pension Plan and recommend whether or not an increase in the rate of contributions should be required.

53. A copy of the relevant Minutes of Proceedings and Evidence (*Issues Nos. 1, 2, 15, 16, 17, 18, 19, 20, 23, 24, 25, 26, 27, 28, 29 and 30*) is tabled.

Respectfully submitted,

RON HUNTINGTON

Chairman

1978 Report of the Auditor General of Canada – Appendix F

<BODY BGCOLOR="#FFFFFF">

<CENTER>

<H1>APPENDIX F</H1>

</CENTER>

<HR>

REPORTS OF THE COMPTROLLER GENERAL TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS:

JUNE 30, 1978

(on the 1977 Report of the Auditor General)

JULY 11, 1978

(on the 1976 Report of the Auditor General)

REPORT OF THE COMPTROLLER GENERAL TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS, JUNE 30, 1978 (Circulated to Members - but not tabled in PAC)

June 30, 1978

Mr. Ron Huntington, M.P.,
Chairman of the Standing Committee on Public Accounts,
House of Commons,
Ottawa, Ontario.
KIA OA6.

Dear Mr. Huntington:

The purpose of this letter is to advise you of the actions reported to the Treasury Board Secretariat by departments and Crown Corporations on some of the matters raised in the 1977 Report of the Auditor General. This is to facilitate the work of your Committee in its review of the Report.

Actions have been instigated to resolve matters raised in sixty-four of the paragraphs in Parts 10 through 17 of the Report. Appendix I explains the nature of the problems originally reported by the Auditor General and briefly outlines the departmental corrective actions. In certain instances, we have described actions that have been taken by departments but are not yet completely effective. In this connection, it should be possible for the Auditor General to report on final resolution of such items during the next fiscal year, 1978-79.

There are sixteen paragraphs where it is not possible at this time to determine either that the actions which have been initiated will resolve the problems or what the final actions should be. These are set forth in Appendix II. We will continue to monitor these issues in order to ensure that corrective actions are taken where necessary and will provide you with status reports periodically.

The balance of the sections of the 1977 Report have been or will be separately reported to your Committee, as detailed below:

- Parts 3 to 6 were reported to Committee during its consideration of the Computer and Information Systems Evaluation (CAISE) Study.
- Part 7 covers the results of the current financial management and control practices study. We have already discussed these matters with your Committee insofar as they relate to Crown Corporations and would recommend that we follow the same process for departments and agencies. Please let us know if you would like us to pursue that course of action.
- Parts 8 and 9 of the 1977 Report comprise a review of the actions taken to correct the deficiencies in financial management and control practices of departments, agencies and Crown Corporations reported during 1975 and 1976. This reporting does not entail further commentary from us.

- Paragraphs 12.1 to 12.11 covering the government-wide issues respecting grants and contributions have been reported separately to and have been discussed by your Committee.
- Paragraph 14.10 is a report on the status of implementation of the recommendations of the Study of the Accounts of Canada. We will continue to advise the Auditor General of progress in implementing the recommendations so that he may report thereon.
- Part 18 comments on matters dealt with in previous years' Reports and provides the status of corrective actions underway.
- The remaining paragraphs in the Report are introductory or comprise commentary where no further action appears to be required. Included in these paragraphs are those in Part 10 (10.6 to 10.14) which refer to previous special audits and inquiries. The corrective action being taken is summarized in the Report.

We have forwarded a copy of this letter and the attached Appendices to the Auditor General and have requested his confirmation that those matters dealt with have been summarized adequately in the Appendices. He has so confirmed.

I trust that this information will be useful to you and your Committee in reviewing the 1977 Report of the Auditor General.

Yours sincerely

H.G. Rogers.

Attachment

APPENDIX I

1977 REPORT OF THE AUDITOR GENERAL

PARAGRAPHS WHERE CORRECTIVE ACTION HAS BEEN INSTIGATED

Paragraph Number and Problem

11.13 **External Affairs**
Advances and submission of claims

The provisions of the Foreign Service Directive relating to advances and submissions of claims were not always adhered to.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Under-Secretary issued a Circular Letter in December, 1977 to all departmental personnel drawing attention to observations by the Auditor General and requesting compliance with accountability requirements.

Paragraph Number and Problem

11.14 **Treasury Board Secretariat**
Accommodation and Meals

1. There is no requirement in the Foreign Service Directives that self-contained accommodation be obtained for employees in travel status for extended periods.
2. Different provisions exist within the Foreign Service Directives and the Treasury Board Relocation Directive for meal expenses incurred by employees on relocation in Canada and the United States.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. An amendment will be proposed to require employees in travel status for extended periods to obtain self-contained accommodation.
2. A recommendation will be made by the Secretariat that the Treasury Board Relocation Directive apply to meal expenses incurred on relocation in Canada and the United States.

Paragraph Number and Problem

11.15 **External Affairs**
Substantiation of Claims

Some of the foreign travel files had incomplete documentation.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Under-Secretary issued a Circular Letter in December 1977 drawing attention to observations by the Auditor General and requesting compliance with documentation requirements.

Paragraph Number and Problem

11.16 External Affairs
Composite allowances

The department pays composite allowances to members of Canadian delegations to international conferences and meetings whereas, under the Treasury Board Travel Directive, the Department only has authority to pay actual and reasonable expenses.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Approval to pay composite allowances was obtained from Treasury Board on December 1, 1977.

Paragraph Number and Problem

11.18 Supply and Services
Central Travel Service Reservation and ticket services

There are no formal arrangements with the two major airline companies governing the reservation and ticket services provided for government employees.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The arrangements have been finalized and the terms and conditions agreed to by the carriers. Formal signing of the agreements is expected within the next few weeks. The effective date is 1 April 1978. A Treasury Board Circular describing the new arrangement will be published as soon as the formal agreements have been signed.

Paragraph Number and Problem

12.15 Energy, Mines and Resources
Approval of Grants, Contributions and Lack of Agreements

1. Documentation of review and approval decisions was inadequate.
2. No formal agreement exists for contributions made to one project.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Steps to correct deficiencies in this area have been taken.
2. Any future commitment of funds to this project will be supported by a signed agreement.

Paragraph Number and Problem

12.16 Energy, Mines and Resources
Monitoring and Evaluation of Projects

Monitoring and evaluation procedures were inadequate in several instances.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Steps have been taken to correct deficiencies in this area.

Paragraph Number and Problem

12.17 Energy, Mines and Resources
Substantiation of Claims for Payment

On a number of occasions, project expenditure claims were approved for payment without adequate supporting documentation.

Corrective Action Taken and/or Being Taken to Resolve the Problem

In future, the Department will ensure that proper supporting documentation is received.

Paragraph Number and Problem

12.18 Energy, Mines and Resources
Internal Financial Controls

Inadequacies exist in the system of internal financial controls, particularly those relating to spending and payment authorities.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Financial clerks now check authorities to the Financial Signing Authority Matrix.
2. An annual review of signing authorities has been implemented.
3. Procedures now require that cancelled signature cards be retained on file for a two year period.

Paragraph Number and Problem

12.20 Employment and Immigration
Disclosures in the Estimates and Public Accounts

1. The Main Estimates do not identify clearly some programs.
2. Inconsistencies in allocating costs to operating or contribution Votes make it difficult to identify the true costs of contribution programs.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. A new program/activity structure and description has been included in the 1978/79 Main Estimates.
2. A review of the classification of items under operating or contribution votes will be conducted.

Paragraph Number and Problem

12.21 Employment and Immigration
Terms and Conditions of Programs

1. Many required conditions and some major administrative practices were omitted from the document submitted to Treasury Board for the Canada Manpower Adjustment Program.
2. Contributions were paid before Treasury Board approval of terms and conditions for a program was received.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Terms and conditions for the Canada Manpower Adjustment Program will be reviewed and revised as necessary to include items required by Treasury Board policy.
2. Steps will be taken to ensure that new programs are not implemented before Treasury Board has approved the applicable terms and conditions.

Paragraph Number and Problem

12.22 Employment and Immigration
Approval of Contributions

Weaknesses exist in procedures for approving contributions and in adherence to these procedures by program officers.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A procedure will be developed to ensure that payment authority is exercised by a financial officer.

Paragraph Number and Problem

12.23 Employment and Immigration
Contribution Agreements

1. Contributions were not always subject to a formal signed agreement describing the program terms and conditions.
2. Contributions have been paid for expenses incurred by recipients that are not in accordance with the terms and conditions of the programs and agreements in effect.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Formal signed agreements will be obtained.
2. The departmental financial administration manual, to be published by September 1978, documents in detail the pre-audit and verification standards and procedures for all payments.

Paragraph Number and Problem

12.24 Employment and Immigration
Monitoring and Evaluation of Programs

Several weaknesses were found in monitoring practices and procedures.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Steps have been taken to upgrade both the quality of monitors and the design of monitoring checklists. There will also be greater emphasis on high level review of monitoring activities.

Paragraph Number and Problem

12.25 Employment and Immigration
Canada Manpower Centres

Many weaknesses were found in the administration of the three contribution programs which are the responsibility of Canada Manpower Centres.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Steps are being taken to correct the weaknesses identified by the Auditor General.

Paragraph Number and Problem

12.26 Employment and Immigration
Internal Financial Controls

Serious weaknesses existed in the system of internal financial controls related to grants and contributions.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Steps have been taken and are being taken to correct the weaknesses noted by the Auditor General.

Paragraph Number and Problem

12.28 Secretary of State
Federal-provincial Agreements

Weaknesses related to terms and conditions and claims for payment were identified in certain cost-sharing agreements with the provinces.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Steps are being taken to correct the weaknesses noted by the Auditor General.

Paragraph Number and Problem

12.29 Secretary of State
Capital Grants

1. No formal assessment committee has been appointed for capital grants under the Arts and Culture Program.
2. Architectural plans and anticipated project costs are not adequately analyzed before grants are approved.
3. Recipients of capital grants do not always provide the required information.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. A formal assessment committee will be established.
2. Assistance from Public Works will be obtained for major proposals.
3. Progress reports will be required in future.

Paragraph Number and Problem

12.30 Secretary of State
Internal Financial Controls

Weaknesses exist in budgetary control, delegation of signing authorities, validation of claims and control and evaluation of grants and contributions.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Several steps are being taken to correct the weaknesses in internal financial controls noted by the Auditor General.

Paragraph Number and Problem

12.32 Canada Council
Documentation in Support of Applications and Awards

There was a lack of adequate documentation on some files for applications submitted and for subsequent action on individual projects.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The policy and procedures manual currently being developed will set documentation standards.

Paragraph Number and Problem

12.33 Canada Council
Monitoring and Evaluation

In some programs, the required progress reports, financial statements and final reports on completion of projects were not submitted.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Efforts will be made to ensure compliance with existing requirements.

Paragraph Number and Problem

12.34 Canada Council
Procedures Manual

A policy and procedures manual is needed.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A policy and procedures manual is being developed.

Paragraph Number and Problem

12.35 Canada Council
Internal Financial Controls

Significant weaknesses exist in the internal financial controls related to budgets and spending and payment authorities.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The new Financial Procedures Manual will correct the weaknesses noted.

Paragraph Number and Problem

12.37 National Museums
Change from Contributions to Grants

The transfer of certain funds from the contributions category to the grants category needs to be reviewed with Treasury Board in relation to the planned directive on grants and contributions.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The classification of certain funds as grants will be reviewed with Treasury Board.

Paragraph Number and Problem

12.38 National Museums
Control over Advance Payments

Procedures for monitoring and control of advance payments are not adequate.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Outstanding advance balances were established by recipient, by year as of March 31, 1977. (After this date the classification of the program has changed from contribution to grants.) The Regional Officers and Program Coordinators, of the Museum Assistance Program, have been requested to follow up on each of these outstanding advances and to undertake necessary action to have the recipients account for the contributions received. Internal Audit will be monitoring the progress of this project.

Paragraph Number and Problem

12.39 National Museums
Reporting and Evaluation

The standard letter used to inform recipients of terms and conditions of project funding does not include a requirement for audited financial statements.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The standard letter will be revised to include a requirement for audited financial statements.

Paragraph Number and Problem

12.40 National Museums
Internal Financial Controls

1. Financial control weaknesses exist in the areas of delegation of signing authority and financial reporting.
2. All payments were not supported by adequate documentation.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Steps are being taken to correct the weaknesses noted.
2. All payments are now supported by adequate documentation.

Paragraph Number and Problem

12.42 National Research Council
Scholarships and Grants in Aid of Research

1. Clear policies and guidelines for the scholarships and grants committees at the National Research Council need to be established and enforced.
2. The authority of the various committees is not clear.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Steps are being taken to modify future editions of "Background Information and Guidelines for Grant Selection Committees" and to enforce these guidelines.

This became the responsibility of the National Sciences and Engineering Council on May 1, 1978.

2. Action has been initiated on this issue.

Paragraph Number and Problem

12.43 National Research Council
Canada-France-Hawaii Telescope Project

Relevant financial information on the Canada-France-Hawaii Telescope Project needs to be included in the annual report of the National Research Council.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Relevant financial information will be included in the President's Annual Report.

Paragraph Number and Problem

14.3 Treasury Board Secretariat
Internal accounts to be deleted

The reported assets and liabilities of the Government of Canada at March 31, 1977 are overstated by \$2,601 million and \$38 million respectively because parliamentary approval has not been obtained to write off internal accounts.

Corrective Action Taken and/or Being Taken to Resolve the Problem

It is intended that parliamentary approval to write-off the internal accounts will be requested during 1978-79.

Paragraph Number and Problem

14.5 Treasury Board Secretariat
Loans and advances, the carrying value of which is questionable

The Auditor General identifies a number of loans, the carrying value of which is questionable. These include:

1. \$1,412 million to Canadian National Railways
2. \$330 million to National Harbours Board
3. \$625 million in principal and \$216 million in interest in arrears to The St. Lawrence Seaway Authority
4. \$1,430 million in special loans assistance to developing countries
5. \$158 million to Atomic Energy of Canada Limited

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Bill C-17 an Act to amend the Canadian National Railways Capital Revision Act and the Railway Act provides for the conversion of not more than \$808 million of this debt to equity.
2. Parliamentary approval to forgive \$4.2 million is requested in Supplementary Estimates B, 1977-78. Further changes are planned when revised ports legislation is enacted.
3. Appropriation Act No. 1 1977 approved the conversion of the \$625 million in principal to equity capital. It is intended to seek approval to write-off the interest in 1978-79.

4. Parliamentary approval to forgive \$232 million of special loans to developing countries is requested in Supplementary Estimates B, 1977-78.
5. Supplementary Estimates A, 1977-78 provided authority to forgive \$88 million and convert the remaining \$70 million to equity.

Paragraph Number and Problem

14.6 Treasury Board Secretariat
Deficit of Crown Corporations for which parliamentary appropriations are likely to be sought

The following amounts are likely to require parliamentary appropriations:

1. \$160 million deficit of the Canadian Dairy Commission
2. \$22 million deficit of Canadian National Railways arising on the overpayment of a subsidy
3. \$181 million deficit of Atomic Energy of Canada Limited

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. An appropriation was obtained in Supplementary Estimates 8, 1977-78.
2. An appropriation was obtained in Supplementary Estimates A, 1977-78.
3. Appropriations seeking forgiveness of interest and a rationalization of the financial structure for the corporation were included in Supplementary Estimates A and B, 1977-78.

Paragraph Number and Problem

14.8 Treasury Board Secretariat
Allowance for losses on realization of assets

There is no policy for establishing allowances for losses on realization of assets.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A study on valuation of assets is underway. One portion of that study includes the development of policies on allowances for losses on realization of assets.

Paragraph Number and Problem

15.4 Transport Canada
Airports Revolving Fund Uncertainty of Realization of Capitalized Development Costs

The Auditor General notes that there is uncertainty whether \$44 million of capitalized development costs will be recovered because of a decision to defer the construction of an airport at Pickering.

Corrective Action Taken and/or Being Taken to Resolve the Problem

An overall review of the Airports Revolving Fund is being made. This review is to provide recommendations for the disposition of costs associated with the land at Pickering.

Paragraph Number and Problem

15.5 Atomic Energy of Canada Limited
Carrying Values of Prototype Nuclear Power Stations in Excess of Estimated Realizable Value

The Auditor General notes that it is not known whether sales proceeds will be sufficient to recover the carrying values of the Douglas Point and Gentilly I nuclear power stations.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Gentilly I station has been written off as a research, development and demonstration facility. The carrying value of the Douglas Point station (exclusive of heavy water) will be depreciated commencing in fiscal year 1977-78 over the remaining useful life (20 years).

Paragraph Number and Problem

15.6 Canadian Arsenals Limited
Failure to Record Fixed Assets and Depreciation

The Auditor General notes that fixed assets purchased with funds provided from appropriations should be capitalized and depreciated and that there is no charge for the use of fixed assets purchased by Canada before the Company was established.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Company, in conjunction with Treasury Board: is presently examining the most effective means of transferring title. When title is transferred, an appropriate charge will be recorded in the accounts.

Paragraph Number and Problem

15.7 Canadian Arsenals Limited
Inadequate Control over Inventory

The company did not count \$17 million of inventory held on behalf of other government departments and one-fifth of its own inventory.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A physical inventory was taken on March 31, 1978.

Paragraph Number and Problem

15.8 Canadian Broadcasting Corporation
Accrued Interest not Recorded

The Corporation has not recorded accrued interest on loans from Canada on which principal and interest payments were deferred until 1979.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The accrued interest on loans from Canada will be recorded and the liability reflected in the 1977-78 financial statements.

Paragraph Number and Problem

15.11 Supply and Services

Defence Production Revolving Fund inadequate Accounting for Public Property

The Auditor General qualified his report because:

1. accounting records were not adequate to distinguish what portion of an asset of \$28.3 million represented progress payments and what represented inventories held by others;
2. inventories held by others were not counted; and
3. other inventories of \$774,000 were not counted.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. A course of action has been implemented to ensure that the financial statements for the fiscal year 1977-78 will be in accordance with departmental policy and generally accepted accounting principles, and be supported by proper accounting records.
2. Inventories of the Defence Production Revolving Fund were counted at year-end by the holders of the inventories. The Comptroller, Supply Administration has directed that certificates will be requested from the holders of the inventories to confirm inventory quantities.
3. Same as for 2 above.

Paragraph Number and Problem

15.12 National Capital Commission

Capital Assets Recorded at Values Greater than Amounts to be Realized on Disposal

The Auditor General notes that certain properties are to be disposed of at amounts substantially less than cost and that these were carried at cost rather than at estimated realizable value.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Consultants are continuing to assist the Commission in identifying the properties. The Commission has estimated the cost of the properties to be transferred and will reduce the book value of its assets accordingly in the 1977-8 Financial Statements. Final adjustments will be made when the exact cost of the properties involved has been determined.

Paragraph Number and Problem

15.13 National Capital Commission

Failure to Depreciate Fixed Assets

The Auditor General notes that the Commission does not depreciate fixed assets that may deteriorate or become obsolete.

Corrective Action Taken and/or Being Taken to Resolve the Problem

At the Commission's request the policy of recording depreciation by Crown Corporations is being studied by the Treasury Board who will be consulting Crown Corporations in July 1978.

Paragraph Number and Problem

15.14 National Harbours Board
Absence of Adequate Documentation sorting Estimated Useful Lives of Fixed Assets

The Board has not been systematically reviewing the estimated useful lives of its fixed assets and as a result does not have adequate documentation to support depreciation charges.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A review of the Board's fixed assets and depreciation policy has been carried out.

Paragraph Number and Problem

15.15 The St. Lawrence Seaway Authority
Inadequate Provision for Depreciation of Fixed Assets

The Auditor General qualified his report because no provision was made for depreciation on the major Portion of its fixed assets.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A revised depreciation policy, which is to be effective April 1, 1978, will provide for depreciation of all fixed assets.

Paragraph Number and Problem

15.16 Supply and Services
Supply Revolving Fund - Inadequate Procedures to Control Public Property

The Auditor General was unable to satisfy himself as to both the quantities on hand and the valuation of \$1.9 million of inventory at Goose Bay, Labrador because no physical count had been taken.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A physical count was taken during October 1977. This wall-to-wall stocktaking, which was attended by representatives from the Auditor General's Office, resulted in a credit adjustment to the inventory value at Goose Bay, as 31 October 1977 in the amount of \$120,328.14.

Paragraph Number and Problem

15.18 Telelobe Canada
Delayed Financial Settlements for External Telecommunications Systems

The Auditor General qualified his report because settlements among the partners of the Commonwealth Telecommunications Organization have not been finalized for the years subsequent to March 31, 1969 as a result of delays by some of the partners in submitting data.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Company is putting all possible pressure on partners who are in arrears in providing the necessary financial data.

Paragraph Number and Problem

16.1 Canadian International Development
Agency - Collection of Insurance Proceeds not Followed Up

The Agency replaced a shipment of wood pulp damaged in transit without securing a written agreement from the recipient as to the disposition of the insurance proceeds on the damaged shipment and did not follow up recovery of the insurance proceeds until the Audit Office raised the subject.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Full settlement was received and deposited on April 19, 1978. In future, the matter of transportation insurance will be included in Memoranda of Understanding.

Paragraph Number and Problem

16.2 Communications
Working Capital Advance Exceeded

The authorized amount that could be advanced to the Government Telecommunications Agency Revolving Fund was exceeded in seven months of the 1977 fiscal year.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Treasury Board approval was obtained to increase the maximum authorized advance from \$2 million to \$6 million.

Paragraph Number and Problem

16.3 National Defence
Revenue Improperly Credited to a 1976-77 Appropriation

The Department incorrectly credited a 1976-77 appropriation with a refund from a supplier that arose because of an overpayment in the preceding fiscal year.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Revised invoice processing procedures, which were in the final stages of development at the time of the overpayment, were introduced in March 1976 and further errors of this type should be eliminated.

Paragraph Number and Problem

16.4 National Film Board Improper
Charge to a 1976-77 Appropriation

The Auditor General believes that \$625,000 was improperly charged to Vote 70 as a result of not applying the full amount of co-sponsors contributions against current expenditures for the Challenge for Change Program.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A different method of accounting for the funds will be sought to ensure proper application of contributions in future.

Paragraph Number and Problem

16.6 Secretary of State
Unauthorized Establishment of a Trust Fund

The Auditor General notes that the Department acted improperly in requisitioning and depositing a cheque for \$2,029,000 with a trust company during 1973 since it had no authority to pay the grant prior to approving the construction plans.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The funds held by the trust company have been returned to the Consolidated Revenue Fund.

Paragraph Number and Problem

16.7 Employment and Immigration
Unauthorized, and Excessive Advance Payments Under the Local Initiatives Program

In the Auditor General's opinion:

1. Treasury Board approval should be sought for advance payments under the Program; and
2. advances should be limited to the immediate requirements of project sponsors or to a reasonable percentage of the total project costs.

Corrective Action Taken and/or Being Taken to Resolve the Problem

1. Treasury Board now requires that terms and conditions related to advance payments be submitted for approval.
2. A recent Treasury Board directive sets limits on the amount of advances which can be made. Any exception to these limits must be specifically authorized by Treasury Board.

Paragraph Number and Problem

16.9 Secretary of State
Contribution Overpaid by \$68,000

The Department exceeded its authority to contribute to an organization by \$68,000 when it paid \$300,000 rather than \$232,000, which would have been the amount if the basis outlined when Treasury Board approved the contribution had been followed.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The \$68,000 will be recovered from the organization as soon as possible.

Paragraph Number and Problem

16.10 Secretary of State
Grants Paid Without Proper Authority

The Auditor General notes that payments of \$1,455,000 were made without proper authority from Treasury Board largely because the Department interpreted the maximum limitation of \$150,000 per project to be an annual one.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Department will request Treasury Board approval to regularize expenditures which exceeded the authorized limit.

Paragraph Number and Problem

16.11 Solicitor General
Unauthorized Payment to Provinces for Prison Care

The Department paid \$769,000 in excess of the amounts authorized under certain terms of prison care agreements with the provinces.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A legal review of the prison care agreements was undertaken and, on its completion, interpretations were disseminated to the concerned regional officials. Uniform operating procedures are also being prepared to prevent a reoccurrence.

Paragraph Number and Problem

16.12 Transport
Unauthorized Payments Under Long-Term Contract

The Auditor General notes that progress payments exceeding \$600,000 were made before they were called for under the terms of a long-term \$20 million contract.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The contract is being amended to permit progress payments for value received within the framework of the milestones set by the contract.

Paragraph Number and Problem

17.2 Canadian Saltfish Corporation
Questionable Trade Practices

The Auditor General notes that the Corporation inflated sales invoices relating to approximately \$8 million of the fiscal year's net sales of \$15 million and, in some cases, paid rebates in accordance with customers' instructions.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The practice was discontinued in March 1977. The Board of Directors also drafted a code of ethics, established an audit committee and requested an independent report on whether there had been any benefits to employees of the Corporation as a result of this practice. The report confirmed that there was no benefit to any employee of the Corporation.

Paragraph Number and Problem

17.3 External Affairs
Questionable Lease Arrangements

The Auditor General notes that in certain countries, lease arrangements such as double leases and lump sum cash payments were made to secure accommodation.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The leasing arrangements noted by the Auditor General are being discontinued.

Paragraph Number and Problem

17.4 Canadian Transport Commission
Overpayment of Subsidies to a Railroad

Subsidy overpayments totalling \$22 million were made to, and recovered from the Canadian National Railways by the Commission. However, the Company's deficit for 1974 and 1975 will increase by that amount and an appropriation will have to be sought by the Department of Transport to pay that amount to the Company.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The \$22 million was recovered through adjustment of advance subsidy payments for 1977 and the deficits were provided for in 1977-78 Supplementary Estimates.

Paragraph Number and Problem

17.5 Environment
Serious Weaknesses in the Administration of the Fishing Vessel Insurance Plan

The Auditor General notes that there are serious weaknesses in the administration of the Plan as a result of failing to properly set out its objectives or accounting procedures in writing.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Action has been taken on many of the observations. The remainder will be resolved in conjunction with a major review of the Fishing Vessel Insurance Plan.

Paragraph Number and Problem

17.6 Health and Welfare
Canada Pension Plan - Projected Deficiency

The unfunded liabilities of the Plan are not recognized in the financial statements and these statements are not intended to show, nor do they purport to show, the adequacy of the balance in the Canada Pension Plan account to meet, on an actuarial basis, the future obligations of the Plan.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The Superintendent of Insurance has agreed to prepare an estimate of unfunded liability for the Canada Pension Plan for inclusion in the next CPP Actuarial Report.

Paragraph Number and Problem

17.7 Transport
Cost of Vacant Office Space

The Auditor General points out that more than 99,000 square feet of rented office space in Tower "C", Place de Ville in Ottawa remained unoccupied for periods up to 10 months at a cost of approximately \$400,000.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The circumstances which resulted in the rental space not being occupied were unusual and are not expected to reoccur.

Paragraph Number and Problem

17.8 Transport
Inadequate Procedures for Loans of Equipment to Municipal Airports

The Department loaned certain equipment to municipal airports without obtaining Governor in Council approval and without formal agreements.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A standard formal agreement form is being prepared and Governor in Council approval will be requested.

Paragraph Number and Problem

17.9 Urban Affairs
Canadian Habitat Secretariat - Payment for Unused Accommodation

The Secretariat made payments of \$503,000 as settlement for unused accommodation reserved on a guaranteed basis for the United Nations Conference on Human Settlements held in Vancouver.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The steps taken were necessary to ensure the success of the Conference. The circumstances giving rise to the payment are not expected to reoccur.

Paragraph Number and Problem

17.10 Employment and Immigration

Weaknesses in Control over Unemployment Insurance Benefit Payments

The Auditor General identified a number of significant control weaknesses, and a lack of adherence to administrative procedures. He also estimated the amount of overpayments which had not previously been identified.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Both improvements made and planned were reported to the Public Accounts Committee at its meetings of February 16 and February 21, 1978.

APPENDIX II

1977 REPORT OF THE AUDITOR GENERAL

PARAGRAPHS WHERE CORRECTIVE ACTION HAS NOT BEEN REPORTED

TO THE CHAIRMAN OF THE PUBLIC ACCOUNTS COMMITTEE

Paragraph Number and Problem

10.21 Treasury Board Secretariat Use of Statistical Data observation and recommendation

There is a significant use of statistical data in expenditure applications for which the data have not been designed and the appropriateness of the data for these secondary uses has not been evaluated.

11.6 Crown Corporations - Advances

Existing procedures do not provide adequate control over accountability for travel advances.

11.7 Crown Corporations - Transportation expenses

1. The practice of paying "equivalent airfare" results in excessive expenditures of time and money.
2. Verification of claims is inadequate.

11.8 Crown Corporations - Accommodation and living expenses

1. Crown corporations often do not take advantage of the reduced rates for accommodation negotiated by the Federal Government.
2. In some Crown corporations, allowances for meals and incidentals vary considerably from those established by Treasury Board.

11.9 Crown Corporations - Expenses related to extended travel

Some Crown corporations do not provide adequate direction or control on costs incurred during extended periods of travel.

11.10 Crown Corporations - Relocation expenses

Policies on relocation costs are generally inadequate and existing regulations are not always adhered to.

11.11 Crown Corporations - Internal financial controls

Several weaknesses are identified in the internal financial controls over travel and relocation expenditures.

11.19 Supply and Services
Central Travel Service
Billing systems and procedures

Present procedures create substantial problems of financial control for both Central Travel Service and customer departments and agencies.

12.13 Energy, Mines and Resources
Disclosure in the Estimates and Public Accounts

1. Certain approved transfers of allotments within the same Vote were not recorded in the Public Accounts.
2. Grants to research institutes are not always disclosed separately in the Estimates and Public Accounts.

12.14 Energy, Mines and Resources
Grant to one Research Institute

Grant payments were made even though established conditions were not adhered to.

14.4 Treasury Board Secretariat
Loans likely to require parliamentary appropriation for write-off

Certain loans do not represent assets of the Government of Canada. These loans are:

1. \$384 million to Canadian Broadcasting Corporation, National Capital Commission, Northwest Territories and Yukon Territory.
2. \$215 million to a number of least developed countries.

14.9 Treasury Board Secretariat
Valuation of Pension Accounts

The financial statements of the Government of Canada do not reflect any deficiency resulting from actuarial valuations of the Canada Pension Plan or the Supplementary Retirement Benefits Account.

15.17 Supply and Services
Supply Revolving Fund - Revenue not Recorded

The Auditor General observes that included in the deferred revenue of \$14.8 million were amounts that should have been recognized as revenue in the year and that this amount had not been determined.

15.19 Treasury Board Secretariat
Failure to Accrue Employee Termination Benefits

The Auditor General has qualified his reports on the financial statements of a number of Crown corporations and revolving funds because of their failure to accrue the liability for employee termination benefits.

16.5 Regional Economic Expansion
Payment Improperly Charged to a 1976-77 Appropriation

The Auditor General notes that an advance of \$1.5 million on an approved loan of \$20 million, paid on April 14, 1977 and charged to a 1976-77 appropriation, did not meet the requirements of Section 30 of the Financial Administration Act.

16.8 Regional Economic Expansion
Improper Payment Under an Incentive Agreement

The Department made a final payment of \$1.3 million under an incentive agreement with a company even though an essential condition of the agreement had not been met because the Department of the Environment could not provide the required certification relating to pollution control.

**REPORT OF THE COMPTROLLER GENERAL TO THE
STANDING COMMITTEE ON PUBLIC ACCOUNTS, JULY 11, 1978
(Circulated to Members - but not tabled in PAC)**

July 11, 1978

Mr. R. Huntington, M.P.,
Chairman of the Standing Committee on Public Accounts,
House of Commons,
Ottawa, Ontario.
K1A 0A6

Dear Mr. Huntington:

On May 24, 1977 Maurice LeClair reported to Mr. Allan Lawrence on the actions reported to the Treasury Board Secretariat by departments and Crown corporations on the matters raised in the 1976 Report of the Auditor General. He reported at that time that there were 15 paragraphs where it would not be possible during 1977/78 to determine whether the actions which had been initiated would resolve the problems or where the actions required were not readily discernible.

I am pleased to report that 10 of these outstanding issues have now been resolved and action has been either completed or is in process. It should be possible for the Auditor General to confirm that these problems have been resolved during 1978/79.

The appendix attached to this letter explains the nature of the problems and briefly outlines the actions taken. The Auditor General has confirmed to me that this appendix adequately summarizes the matters dealt with in his Report.

With regard to the remaining 5 paragraphs (9.6, 13.12, 16.11, 18.5 and 19.6), I am actively pursuing these matters with the departments concerned and with the Auditor General.

I trust that this information will be useful to you and your Committee.

Yours sincerely

H.G. Rogers

Attachment

1976 REPORT OF THE AUDITOR GENERAL

PARAGRAPHS WHERE CORRECTIVE ACTION HAS BEEN INSTIGATED

Paragraph Number and Problem

9.5 Treasury Board Secretariat Control and Administration of Accommodation

There are no coordinated training programs to ensure uniform application of space accommodation guidelines and directives.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A series of regional seminars will be held to address weaknesses in departmental administration identified in responses to Treasury Board's Guide on the Administration of Office Accommodation.

Paragraph Number and Problem

13.8 Canadian International Development Agency Trainees' Obligations

Trainees do not always honour their agreements to return to home countries so CIDA should consider using contracts containing reimbursement clauses.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Past experience indicates that a reimbursement clause would be very difficult to enforce legally. It was tried in 1969 without success. Moreover, reimbursement is not an answer to the problem of ensuring that trainees return to their home countries where they are needed. The 'general offer' type of training program has been largely discontinued and for the most part, trainees now enter Canada only for specific training to meet the needs of specific projects. This approach tends to reduce the incidence of problems concerning trainees failing to return to their own countries.

Paragraph Number and Problem

13.9 Canadian International Development Agency Field Audit

1. Due to staff shortages only 15 of 1,000 projects were audited in 1974-75 and 1975-76.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Efforts have been made to increase audit staff, subject to the constraints of man-year controls and recruiting difficulties and to increase the number of projects audited. Coverage has increased as follows:

1974-75- 6 audits

1975-76-	9	audits
1976-77-	15	audits
1977-78-	46	audits
1978-79-	60	planned

Present coverage represents approximately 10% of the value of all projects. Criteria have been established to ensure a representative sample of projects is selected for audit. This sample reflects the pattern of activities as well as concentrating on larger dollar value projects.

Efforts to increase the coverage will continue.

Paragraph Number and Problem

2. It is impossible to determine real costs of projects because of a lack of information in certified financial statements.

Corrective Action Taken and/or Being Taken to Resolve the Problem

Effective April 1, 1977, non-governmental organizations, have been required to sign a letter of agreement detailing the terms and conditions of CIDA's contributions. The agreements commit NGOs to separate budgeting and accounting for CIDA-assisted projects, the provision of interim and final financial reports, and stipulate further that all necessary records should be available for audit by CIDA or its representatives.

Paragraph Number and Problem

16.10 Canadian Broadcasting Corporation
Accrued Interest not Recorded

The Auditor General qualified his report for failure to record \$28 million of interest which was deferred to March 31, 1979 by Order in Council.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The accrued interest on loans from Canada will be recorded and liability reflected in the 1977-78 financial statements.

Paragraph Number and Problem

16.18 Atomic Energy of Canada Ltd.
Canadian Broadcasting Corporation
The St. Lawrence Seaway Authority
The Seaway International Bridge Corporation, Ltd.
Farm Credit Corporation

The Auditor General qualified his reports on the financial statements of these corporations because of the failure to accrue the liability for employee termination benefits.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The corporations have adopted the practice of accruing the liability for employee termination benefits.

Paragraph Number and Problem

17.1 Post Office Failure to Recover Costs of Trans-Border Highway Services between Canada and the United States

The United States has not paid its share of certain costs of trans-border highway services provided by Canada.

Corrective Action Taken and/or Being Taken to Resolve the Problem

A joint review (Can. & U.S.) of transborder highway services revealed cases where both administrations had failed to pay their share of the costs. Each administration agreed to conduct a separate review to determine costs. Our review is complete. The U.S. has been advised of their share and partial payment has been received. A final settlement will be made when the U.S. review is complete.

Paragraph Number and Problem

18.1 Atomic Energy of Canada Ltd. Payments to Agents Inadequately Documented

The Auditor General states that the documentation supporting payments of \$8,098,500 is inadequate and lacking in detail; and that the first quarterly statement pursuant to "Contract Support and Services" does not provide information on the nature of expenses incurred.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The available documentation supporting agency payments was fully discussed and documented before the Public Accounts Committee and was the subject of a Report dated February 22, 1978.

Paragraph Number and Problem

18.6 Farm Credit Corporation Low Return on Long-Term Mortgage Credit to Farmers

During periods of rising interest rates loans approved in one six month period and disbursed in another considerably reduce or eliminate the 1% margin provided by regulation.

Corrective Action Taken and/or Being Taken to Resolve the Problem

In areas where the time lapse between the date of loan approval and the date of loan disbursement has been excessive, the Corporation has imposed a time frame for completion of the legal work by the solicitors involved, in an effort to expedite the processing of loan applications through to the disbursement stage. By reducing this time lapse, losses incurred by the Corporation due to reduced margins caused by interest rate changes in times of rising interest rates, should be reduced accordingly.

In a further effort to maximize the margin realized on loans made during periods of rising interest rates, the Corporation is also reviewing the feasibility of using moving averages as a basis for establishing both borrowing and lending rates.

Paragraph Number and Problem

19.7 National Revenue - Taxation
Insufficient Penalty for Late Payment of Income Tax

The Auditor General states that an increase in late payment penalties could assist in the collection of accounts.

Corrective Action Taken and/or Being Taken to Resolve the Problem

The March 31, 1977 Budget proposed an increase in the rate of interest on underpayments and overpayments of income tax to bring it in line with the prime rate charged by chartered banks. The required change to Income Tax Regulation 4300 to raise the rate to 8 per cent for 1978 has been agreed between the Ministers of the Departments of Justice and National Revenue - Taxation, and the appropriate wording of the regulation is now being developed by the Department of Justice.

Paragraph Number and Problem

19.8 Services Canada
Errors in Public Service Superannuation Account Pension Plan and Contribution Calculations

The Auditor General reports a continued high incidence of error in pension and contribution calculations.

Corrective Action Taken and/or Being Taken to Resolve the Problem

As the Auditor General has observed, the Superannuation Division of the Department of Supply and Services continues to show improvement in the determination of benefits payable from the Public Service Superannuation Account. Numerous improvements have been planned and implemented.